MARKET ORGANIZATION

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MARKET ORGANIZATION

AN INTRODUCTORY COURSE

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FOREWORD

This book represents the subject matter which is proposed for one-third of the freshman course in economics at the University of Minnesota. It is the outgrowth of several years' experimental work on the part of its authors with materials which would serve both as an introduction to the field of economics and as a description of industry. The problem of presenting a preliminary survey of the field which would serve as an introduction to the field of business administration has confronted the faculty here as it has in other collegiate schools of business. At first a purely historical approach to the field was attempted. This was followed by a course which might be termed a description of industry. While this afforded ample materials of an interesting type to the student, it lacked a definite body of principles.

It was finally concluded to give the entering student a full year's introductory course which would present: first, a rounded picture of the organization of industrial society; second, a body of principles as they apply to the fields of production, marketing, and finance; and third, a sufficient acquaintance with these fields to serve as a basis for orienting the student to these phases of modern business administration.

The course is divided into three parts each running for a term of twelve weeks with five class sessions per week. One term is given over to Marketing, for which this book is used as a text. Another term is devoted to Production. A text for this course has been prepared by Professors J. D. Black and A. G. Black. In the third term a course entitled the Mechanism of Exchange presents the main features of the financial organization of society.

These three courses precede the formal course in the Prin-

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ciples of Economics. The materials have been purposely arranged in this way. The student is introduced to the principles in a logical sequence in connection with the description. The course in principles which covers one term is restricted largely to a consideration of the principles of value and price.

While this book has been prepared primarily for one section of the freshman course, it contains a well-rounded body of materials which will be found adequate for an independent course in marketing

R. A. Stevenson

Dean, School of Business Administration
University of Minnesota

PREFACE

This book seeks to introduce the subject of marketing to college students. In the selection and presentation of material, the requirements of those beginning the study have been borne in mind throughout. It is used in one section of the introductory economics course at the University of Minnesota, as described in the Foreword by Dean Stevenson. Its arrangement and subject matter are such, however, that it may either follow or precede a course in Principles of Economics.

The authors have had three reasons in mind for undertaking the present work: (1) the dynamic situation with respect to marketing requires frequent, up-to-date presentation; (2) the "architectural design" of the book is a new and, we believe, a useful approach to a course in marketing; (3) current writings in the field of marketing are so voluminous and contradictory that a winnowing of some of the wheat from some of the chaff has seemed worth while.

In all marketing there is a group of "functions" which must be performed. The method of performance will differ somewhat for different commodities, but an appreciation of the functions seems essential to an understanding of marketing. Variations between the institutions which grow up for the handling of each commodity result from these differences between the commodities themselves.

In this book we early introduce the marketing functions and some elementary concepts of trade, in accordance with which these functions must be performed. There follows a brief description of market structure and institutions. Then some of the more important functions are treated in detail: market demand and its manipulation, leading to market price and price policies; market risk, its avoidance through research, and its transference to specialists; the physical movement of goods, locally, between areas, and internationally. This, in turn, leads to an objective study of the costs of marketing and of some of the methods of reducing those costs, which include, in our judgment, various forms of integration, cooperation, and standardization. Finally we come to the growing interest of government in marketing as expressed in legislative control. This is of significance because it represents, in the main, the judgment of business itself, crystallized into formal code.

At the University of Minnesota, this text is supplemented by a series of lectures describing in detail the marketing of specific commodities and the organization of specific institutions. We feel that the text material provides a framework into which the descriptive material may be fitted. Without such framework, the basic relationships might easily be lost in the maze of detail; the forest might be obscured by the trees. With such a framework the changing conditions within specific industries may be described by lectures which can always include the latest developments. After some years of experimentation, this seems to us the most satisfactory method of procedure.

The book is admittedly a mosaic, as we believe any good book on marketing must be at present. We have tried to give credit where credit is due, although some of our ideas may have come to us in such a way that we have neglected to acknowledge the source. We extend our special thanks to Professor W. L. White of Texas, for many helpful criticisms. From the group of instructors who have taught from this material and have discussed it 'around the board' in the long hours of the evenings, we have gained much. And, finally, from the two thousand-odd students who have taken this course in the making, we have gleaned many suggestions which help to make the book what it is.

We have written with our Minnesota teaching problem especially in mind. If, perchance, our book fits into the teaching plan of others, it will have accomplished a double purpose.

Roland S. Vaile
Peter L. Slagsvold

Minneapolis, Minnesota,
May 8, 1930

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MARKET ORGANIZATION

AN INTRODUCTORY COURSE

CHAPTER 1

ECONOMIC ORGANIZATION

An Age of Cooperative Action.—"Man lives not unto himself alone." This seems truer today than ever before. A few hundred years ago families obtained directly everything they consumed. Today, in contrast, most families make nothing which they directly consume. Half a million more people were engaged in the service departments of hotels and restaurants in the United States in 1928 than in 1920, preparing and serving the food which some of us eat.[1] This is but one illustration of the enormously complex age in which we live.

An Example.—Suppose that your parents had undertaken to train you so that you could make, entirely unaided, a watch which would keep accurate time. The imagination needs to play but a moment to see the impossible complexity of such an undertaking. To begin with—if such a problem may be said to have a beginning—there are the various metals out of which the works and the case of the watch must be fashioned. These metals are mined as minerals, then processed and refined, then shaped. But tools are necessary for each of these operations, and expert knowledge is necessary in the forming of such tools. A study of geology is also required to locate the minerals in the first instance. And there are countless details connected with coefficients of expansion and contraction, propulsion by spring power, gear ratios, balance wheels, and what not, until one's head swims. Thus the mere mechanics of the undertaking are tremendous.

If the problem were simplified by offering you all necessary assistance in metal working and machinery, there would still remain the difficulties of applied astronomy, for one is not born with a knowledge of time and the differences between sidereal time and solar time. Both tragedy and romance were interwoven only a few decades ago with the change from local, sun time, to standard, clock time.

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[1] Julius Klein, in *Whither Mankind*, p. 101.

Printing costs and readers' patience are the only limits to illustrations of the complexities of modern business. This is an age which is highly cooperative for the reason that we must take all possible advantage of what others have done if we are to hold our place in the procession.

Man's Wants a Spur to Action.—The greatest single urge to human activity is the desire to obtain goods to consume. The present social structure has evolved—and is still changing—in an attempt to fulfill this desire. "One of the most characteristic marks of a sentient being like man is to have wants—we might almost say that to feel wants and secure their satisfaction is the very essence of living. Again, it is manifest that the satisfaction of any want depends on the presence of the appropriate condition. The satisfaction of physical hunger depends on having food at our disposal; the satisfaction of our craving for affection requires a certain attitude on the part of some other person or persons; the satisfaction of our love of beauty depends on the presence of beautiful objects; and so on. All objects or conditions on which the satisfying of wants is dependent, we shall call *goods,* using the term very broadly. The property of goods whereby they are thus able to satisfy wants we call their *utility.*"[2]

Only part of the goods which possess utility are of interest to us in this course, namely, those which are also so scarce that they have an exchange value or price. Unless the supply of a good is limited, no one need give anything in exchange for it. Water is frequently a free good, but it commands a high price in the desert where it is scarce. Unless the good is useful, no one is willing to give anything for it. Goods having both attributes, scarcity and utility, are commonly called *economic goods*. The desire to possess economic goods encourages people to employ their time at whatever they can do best, so that their supply of goods for exchange purposes will be at a maximum. Economic goods, therefore, help to determine the conduct and occupations of people.

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[2] F. M. Taylor, *Principles of Economics*, 1923, p. 1.

"The general situation in which men find themselves is this: First, they exist, and by the fact of their existence they have wants which imperatively demand satisfaction. Secondly, the satisfying of these wants depends on the possession of certain economic goods. Finally, the getting of the goods depends on some acts, efforts, of man himself. Speaking broadly, man must make his own living. He must perform some part, large or small, in the process by which he becomes possessed of the necessary goods. Now, as making possible the accomplishment of this task, he finds at his disposal two sets of conditions, or instrumentalities: (1) his own outfit of capacities, mental and physical, and (2) an outside world of material objects and conditions which in one way or another can be drawn upon and utilized. Starting with this general situation, there are several possible ways in which his task of making a living might be accomplished.

Different Possible Economic Orders.—"First, an economic order can at least be conceived in which goods needed by the individual are made available by his own efforts, unaided by his fellow men. Crusoe is represented as contriving to satisfy his wants, in so far as they were satisfied at all, almost wholly by the labor of his own hands; and it is possible that many hunters and explorers for a time approximate his condition. A pioneer or isolated settler also to a great extent produces the very things which he consumes and consumes nothing but what he himself produces—bakes his own bread and eats it, grinds his own flour and bakes it into bread, raises his own wheat and grinds it into flour. Such an order, where each man provides directly and entirely for the satisfaction of his own wants, may be called an *autonomous-economic* order.

"At the opposite pole, we have an economic order in which all the people of a community cooperate in a completely organized way in the getting of economic goods. The community owns all the resources, undertakes all the production, and sees that each person gets what he needs or, anyhow, what the community can afford to let him have. Such an economic order is commonly designated *Communism.*"[3]

Present-day Russia is an experiment in communism. As yet it has not been possible, or expedient, to discard all of the attributes of capitalism inherited from an older social order, but the avowed ideal of the Bolshevist Government has been complete communism.

"A somewhat less completely organized system of cooperation would leave to individuals greater freedom of action, in that, while the community owned all the goods used in production and undertook all production, the individual would be hired by the community and paid wages, and would be permitted to buy and own such consumption goods as he chose, instead of being taken care of like the members of a family. A system of this general character is usually called by economists *Socialism* or *Collectivism.*"[4]

There have been many attempted socialistic communities. Most of them have been local in character and short-lived. Many Utopias have been conceived, but few have developed. However, there are many degrees of socialism. Human activities and institutions have been modified by state and group action in numerous cases. Governmental postal service, city water works, educational programs in general, are illustrations of socialistic undertakings.

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[3] Taylor, *op. cit.*, p. 16.

[4] Taylor, *op. cit.*, p. 17.

The Present Order.—"The two possible economic systems last described are both cooperative, as must be all but the one first described—the autonomous one. But neither of these, as the student is doubtless aware, is anywhere fully established, though experiments in this direction are being made on a gigantic scale in various countries. In contrast, the actual system of most civilized countries is one in which the cöoperation involved, instead of being organized, is rather spontaneous, automatic—effected and regulated through free exchange between individuals or non-political groups. This system we shall call one of *Individual Exchange-Cooperation.*"[5]

Under this social system individuals are free to do about as they please. There are, of course, many laws and social taboos which curtail extreme individual expression, but in the main people may govern their own acts. The interplay of individuality in a cooperative social order leads to the spontaneous action of individuals in producing goods wanted by other persons, and in exchanging those goods for goods which the others have produced. The members of society act together in supplying their wants. Each person produces almost entirely for other people's consumption; each person consumes almost entirely what other people have produced. Thus our ability to cooperate is based on our ability to *exchange.*

Some of our most complicated business enterprises and institutions illustrate this point. The Ford Motor Company makes a million automobiles which must be sold to people who will use them. In Detroit a certain department store has sold as much as a million dollars worth of goods in a day—goods which have been brought from the corners of the earth to be exchanged, in part, for the dollars paid to men for tightening bolts on the Ford cars. Or again, "the textile mills in a small New England town come upon hard days; their principal market in far-off North China has dwindled because the sole industry of those remote Mongolian villages has collapsed, thereby destroying the buying power of their poverty-stricken inhabitants. The reason? Their livelihood was gained from making hair nets; the sudden shifts of fancy brought on the bobbed hair 'wave,' and the once thriving Chinese hair net industry now lies buried under 400,000 tons of long locks, which have been shorn since the fashion started—whence comes at least a portion of the distress in the New England textile mills."[6]

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[5] Taylor, *op. cit.*, p. 17.

Cooperation Regulated by Exchange.—The operation of the present order is largely automatic. People produce those goods which they are capable of producing, but—and this is generally more important in determining conduct—people will continue to produce only those goods which they can exchange to advantage. The relative importance of individual economic goods is measured in terms of money and is expressed as a price. One important purpose of modern marketing institutions is the crystallization of the forces of supply and demand into a market price.

"Throughout most of the present order, our cooperation is *regulated* by the same machinery of exchange which *effects* that cooperation, and in the same spontaneous way. If too little of anything is produced, prices rise or the market expands, profits increase, and so producers of their own motion increase output; if, on the other hand, too much of anything is produced, price falls or the market contracts, profits diminish, and so producers of their own motion diminish output. Again, if the output of some commodity during a particular year is exceptionally small, so that consumption all along the line needs to be curtailed, this is usually accomplished, not by the interposition of the public authorities, but by an automatic rising of price which induces almost every one to cut down consumption of his own motion. So in these and various other ways, exchange regulates our cooperation."[7]

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[6] Klein, *op. cit.*, p. 97.

Cooperation Leads to Specialization.—The cooperation which we have been discussing leads to a specialization in activity, each person doing those things which give him the maximum power in exchange. Society is divided into major groups, each performing a special task: farmers and miners produce raw materials of industry; manufacturers convert the raw materials into tools or finished articles for consumptive use; middlemen bring buyers and sellers together, provide convenient trading places and perform other necessary functions; and so on.

Specialization goes much further than indicated above. Individuals perform minor tasks in every field of activity: one mining employee does nothing but set the blasts which shatter the rock; in shoe factories men stand all day smoothing the edges of heels on an emery wheel; in stores cash girls make change interminably, with nothing but gum to relieve the monotony. Specialization makes possible greater efficiency and larger total production; it may, however, sometimes stultify ambition.

Competition Between Specialists.—Between the specialists—whether managers of large enterprises or laborers in the smallest concern—there is competition. That is to say, more than one person is usually ready to exchange either goods or services for anything which is produced. Whenever competition is free, there is unhindered effort of each producer to get or to keep patronage which might go to rivals.

Danger of Monopoly.—There is the possibility, of course, that some certain group will combine to take advantage of the less well-organized members of other groups. Such combinations are known as monopolies or tendencies toward monopoly.

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[7] Taylor, *op. cit.*, pp. 19–20.

Monopoly control provides an opportunity to *give* to the joint cooperative output of society as little as necessary and to *take* from the joint output as much as possible. Occasionally some form of governmental action seems expedient to prevent unfairness resulting from monopoly. Such control will be discussed in a later chapter.[8]

Presumptive Efficiency of Competition.—"The *a priori* grounds on which we might expect free competition to guard us pretty well against the dangers incident to all economic cooperation are easily set forth. If, as a producer, I had no need to think of anyone but my customers, the temptation to gain at their expense might generally prove too strong. But there are other people whom I have to consider, namely, my rivals, other persons producing in the same line as myself. The fear that such persons will get my customers to buy from them instead of from me says to me in very emphatic terms: Do nothing to the disadvantage of your customers; do not put in poor materials or work; do not take advantage of their ignorance; do not try to deceive them; and so on. Put positively, that fear of rivals says: Do everything possible to the advantage of customers; be eager to anticipate their wants; put in better and better materials; improve the quality of your work; show yourself really interested in doing the best you can by them; and so on. Manifestly, we have here a force which tends strongly to offset the dangerous tendencies naturally present in all cooperation.

Enforced Freedom of Competition.—"That free competition must be recognized as a vital, fundamental necessity of the present order is surely evident from the considerations just set forth. Conceivably it might be better to do away with our present system altogether, to substitute therefor a system of organized cooperation like socialism, in which case we should have to depend largely on some other method of avoiding the dangers which grow out of cooperation. But, so long as we attempt to maintain the present system of spontaneous cooperation, we should in every way strive to maintain freedom of competition. And, in fact, this is the almost universal policy of governments at the present time. The only exceptions are those cases where experience has shown that free competition cannot be maintained or its maintenance will, on the whole, work more evil than good. With these, government control or government regulation is substituted for freedom of competition. But these cases are decidedly the exception. The general rule is enforced freedom of competition. Even when governments undertake direct control or regulation, they usually set up as the ideal of their regulation the results which it is conceived would follow where competition is perfectly free."[9]

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[8] See Chapter 24.

The Adequacy of Free Competition.—Shortly after the beginning of the present age of machinery, Adam Smith wrote in his *Wealth of Nations*, "Every man, so long as he does not violate the laws of justice, is left perfectly free to pursue his own interests in his own way, and to bring both his industry and his capital into competition with those of any other man or order of men." As Walter Lippman says in his recent *Preface to Morals,* "The employing class in the early days of capitalism honestly believed, and indeed its less enlightened members still believe to this day, that somehow the general welfare will be served by trusting naively to the acquisitive instincts of the employing capitalists. It has been discovered, however, that if each banker was permitted to do what seemed to him immediately most profitable, the result was a succession of disastrous inflations and deflations of credit; that if natural resources in oil, coal, lumber, and the like were subjected to the competitive principle, the result was a shocking waste of irreplaceable wealth; that if the hiring and firing of labor were carried on under absolute freedom of contract, a whole chain of social evils in the form of child labor, unsuitable labor for women, sweating, unemployment, and the importation of cheap and unassimilable labor resulted; that if business men were left to their own devices, the consumer of necessary goods was helpless when he was confronted with the industries in which there was an element of monopoly." With such little success has the theory of free competition worked under actual experience that it has been modified in every modern community in the course of the last generation by legislation, by organized labor, and by organized business itself.

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[9] Taylor, *op. cit.*, p. 27.

This failure of free competition to give adequate control of our present economic organization is largely the result of imperfect markets. A perfect market is defined in Chapter 4 to include, among other things, equal information, rational action, and equal ability on the part of the principals to act rationally. That these things do not exist, in practice, will be developed as we continue our study.

The Field of Marketing.—In an exchange economy, facilities for making exchanges are highly important. In the broadest terminology, all such facilities are marketing institutions. More narrowly—and more commonly—one entire phase of exchange has been largely separated from marketing; "money economy"—the rôle of money in economic society—is so complicated and is such an important part of social economy that it is considered a separate field of economics. Moreover, money relations are as necessary in manufacturing and in other forms of production as they are in marketing. In this course, therefore, only the briefest attention will be given to the financial aspects of marketing. These very important subjects are treated fully in studies of financial organization.

Economics applied to production in the narrow sense—that is, change of form or change in condition of goods as accomplished by mining, farming, or manufacturing—is not a part of this course.[10] It will be evident to all, however, that there is the closest possible relation between these activities and marketing; often different departments in the same concern perform the two acts, and the two exist for each other. "The separation of marketing from the other phases of production is simply a case of the division of labor. The productive process, when fully developed, may be divided into four fairly distinct parts. These have to do with the creation of *form, place, time,* and *possession utilities.* The farmer, for example, directs the process by which the chemical constituents of soil and air assume the form of fruits and vegetables. The railroad carries them to a place where they are more needed than they are in the immediate vicinity of the farm. The storage company receives them at a time of relative plenty and delivers them at a time of relative scarcity. The market dealers put them into the possession of consumers, or, if the work of production has not been completed, into that of other producers.

"Under very simple conditions no such division of labor is necessary. The farmer may grow potatoes, store them for a short time on the farm, carry them to market in his own wagon, and finally sell them to consumers. Under complex conditions, especially when the original producer and the market are far apart, when the work of marketing takes a great deal of time, or when goods can best be sold only in connection with those furnished by other producers, a division of labor along those lines is necessary. Indeed, some parts of the productive process are, as a rule, elaborately subdivided.

"It must not be supposed that the division of labor necessarily implies that the individuals, firms, or corporations engaged in different parts of the work are entirely independent of each other. Satisfactory mutual dealings naturally result in what is known as 'goodwill' which, though intangible, is sometimes of considerable importance. Relations much more intimate than this are not infrequently maintained. In particular, the corporate form of organization furnishes a means by which those performing very different functions may be united."[11] In spite of this close relationship, the present course will be limited to a survey of the existent marketing mechanism and the institutions engaged directly in furthering the competitive exchange-cooperation.

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[10] Production in this narrow sense may be called "primary production." "Primary production is defined as production which turns out finished or partly finished goods ready for the market, except that they must be transported, stored, and merchandised by some other agency before they reach the hands of those who are to make use of them." Black and Black, *Production Organization,* p. 61.

The Principles of Marketing.—The principles of marketing are of two general types. On the one hand are the principles of production economics. Among these are: (1) the principles of comparative advantage, i.e., the principles of specialization by occupations and by areas; (2) the least cost and highest profit combinations of the production elements in any one marketing unit, i.e., the factors determining the organization and size of the marketing units; and (3) the combination of business units. Application of these principles in marketing studies should help to determine the efficiency of the business set-up of different types of merchants. It should also lead to the establishment of standards of performance, against which individual concerns and established practices may be checked with a view to improved efficiency, both of the individual concerns and, finally, of the whole marketing organization.

On the other hand are the principles of price, involving all the forces which affect supply and demand. Some of these forces are physical, such as the supply of crude oil or the yield of wheat. Some result entirely from the whims and fancies of individuals, such as the fad for Mah Jong or the latest vogue in gowns. Some are due to the vagaries of the money economy with its changing general price level. A study of marketing involves an analysis and measurement of these forces, from which may be ascertained a more complete knowledge of supply and demand. With this more complete knowledge may come a program of production which is better adapted to the demand of consumers. The waste due to maladjustment between production and consumption may be materially reduced, and the loss due to unforeseen price changes may be avoided.

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[11] Report of Federal Trade Commission on "Wholesale Marketing of Food," p. 26.

The purpose of this text is to test existing marketing institutions in the light of these two types of principles and, at the same time, to test the principles in the light of prevailing market practices.

Thus, it appears that a study of marketing is more than a study of the art of buying and selling. The act of buying and selling advantageously is an end to be desired; it is the culmination of a process. It can be successfully accomplished only as the result of skilful handling of the many economic and psychologic problems involved.

While all the principles suggested above are important to this end, it is possibly safe to say that the beginning of wisdom in the development of a marketing program lies in commercial geography, on the one hand, and in human psychology, on the other. The problems of trade cannot be intelligently discussed except in connection with the location of raw materials on the one hand, and centers of consumption on the other. Nor can they be approached with intelligence except in connection with the whims, fancies, and vagaries of Mr. and Mrs. Consumer. Since some of these matters are undergoing constant change, there is no one program of marketing which is "best" for all commodities and for all periods of time.

The location and measurement of the materials for primary production have been accomplished with some degree of adequacy. It is possible, therefore, to study marketing objectively and accurately from this standpoint. The discovery and measurement of the norms of human desires and reactions are equally as important, probably equally as possible of accomplishment, but, as yet, not so adequately undertaken.

Some Marketing Problems.—Nowhere else in business are human relations so intricately involved as in the market place. There countless questions are constantly arising to catch the attention and hold the interest of the student of human affairs. Can cooperative marketing solve the farmer's problem? Will instalment selling ruin more families than it aids? Should resale price maintenance be legalized, or is it already legal? Should the government further regulate the grain exchanges, or has it already gone too far in curtailing future trading? Will the chain store drive the independent store out of existence? Should legislation be passed, limiting the activities and opportunities of chains? Is it possible to forecast the price of wheat or of butter? Is water transportation really cheaper than rail? Who should brand commodities—the manufacturer or the merchant? Why are shoes sold direct to retailers, while groceries are sold through wholesalers? Can consumers save money by trading in low-rent districts and, if so, is the saving the result of low rent? Are there too many middlemen? Are marketing costs increasing and, if so, is it because merchants are inefficient? Is advertising a social waste? These, and many other questions, are heard on all sides. Some of them are specifically discussed in the chapters which follow. For others, the source where the answers may be found is indicated. For still others, the answer must be sought in subsequent study.

CHAPTER 2

MARKETING IN THE BUSINESS ORGANIZATION

Business a Continuous Process.—All economic goods move by a more or less continuous process from origin to consumer. Iron ore is mined, then processed, then shaped; wheat is grown, then milled, then baked; and so on.

Agriculture, forestry, and mining are the principal sources of our raw materials. Occasionally these raw materials are produced and made ready for final consumption by a single social group. Generally, however, they are produced by one social group, processed by a second, further processed or shaped by a third, and finally passed on to the consumer by still another social group. This latter method is a natural outgrowth of the increased specialization and division of labor which characterizes our present economic order.

This specialization by social groups and the resulting "roundaboutness" of present-day marketing may be illustrated by the accompanying diagram.

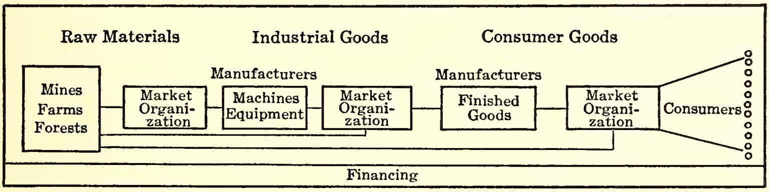
Raw Materials
Industrial Goods
Consumer Goods
Manufacturers
Manufacturers
Mines
Farms
Forests
Market Organization
Machines Equipment
Market Organization
Finished Goods
Market Organization
Consumers
Financing

Figure 1. Marketing as Affected by Specialization by Social Groups

The diagram indicates that marketing organizations are required at several points in the process. Raw materials may be passed through marketing institutions, either to manufacturers of equipment or other industrial goods, to manufacturers of consumer goods, or direct to final consumers. For example, iron ore is generally passed, first to manufacturers of industrial goods, such as rails, and plates; wheat, on the other hand, is passed to millers who in turn sell flour through a marketing organization either to bakers for further processing or direct to consumers. As a third case, fresh vegetables are passed through a marketing organization directly to the consumer.

In general, each of the lines connecting the different specializations implies physical transportation. The problem of transportation is confined neither to the manufacturer nor to the merchant, but is a part of the entire marketing problem. That is one reason why railroads are called public utilities—that is, private property devoted to public service.

In the same way, financing is an all-pervasive process. During any productive undertaking, all operatives must be provided with the necessities of life, pending the consumption of their immediate product. The welfare of all men is involved in the operation of the financial system, and partly for this reason, there are special laws to regulate banks. Hence, financing is shown in the diagram as paralleling all of the other activities.

Techniques Required in the Conduct of Business.—It may also be pointed out that the conduct of business requires the development of special techniques of many kinds. For convenience of study, these may be grouped into four major classes, as follows:

1. Primary production. Mainly concerned with changes in the form of commodities. The principal classes of production, in this sense, are agriculture, mining, forestry, and manufacturing.
2. Marketing. Mainly concerned with changes in the time when, and the place where, commodities are available for use.
3. Financing. Mainly concerned with the ownership of, and payment for, goods and services. Generally a mone-

tary system is established and largely controlled by government. Financial agencies include banks and all other forms of credit institutions.

4. Control. Mainly concerned with keeping the volume of production and consumption in agreement. Financial accounting, budgeting, unit control systems, and statistical forecasts are some of the special techniques used in control. Control is especially important when goods are produced at points far removed, either in space or time, from their place of consumption.

Primary production and marketing are in some measure the more basic of these techniques. They accomplish the physical changes which are necessary, in order that the raw materials of nature may satisfy the desires of people. Financing and control, on the other hand, are facilitating enterprises which make possible the specialized accomplishment of the other two. They add greatly to the scope and to the convenient operation of our exchange economy.

This discussion indicates, in a general way, where marketing organizations belong in the business process. They stand between the manufacturer and his raw materials on the one hand, and the consumer of his goods, on the other. They stand between the producer of semi-manufactured goods and the producer of completed consumer goods. In our present economic system, they stand at all times directly in front of the final consumer. In the last analysis, their importance, their volume, their very existence, depend entirely on the final consumer. No matter what the resources, no matter how fine the tools, no matter how efficient the organization, unless the people want the goods and have the wherewithal to pay for them, there can be no marketing.

Marketing, a Fundamental Problem.—Marketing—the group of these techniques with which we are especially concerned—is of great importance in our present economic system.

"The economical distribution of the absolute essentials, food, clothing, shelter, and fuel, is a fundamental problem which concerns every man, woman, and child in the United States. In earlier times there was no problem of distribution because people lived simply and produced their own foodstuffs, clothing materials, and found fuel and materials from which to create shelter close at hand. They enjoyed such comfort and convenience as they could provide for themselves and service was a matter of neighborly exchange.

"Pioneers traveled into new country and established communities and developed resources. Railroads were developed, goods were transported, and time and distance became factors in the relations and transactions of men. Fertile soil yielded crops beyond the requirements of the tiller of the soil. Forests were converted into building materials for the erection of better homes and into furniture to fill the new homes. Mines were developed and their mineral products converted into machinery to relieve human labor. Farmers exchanged their surplus crops for lumber to build barns and homes and for implements to cultivate the soil and harvest the crops. Traders and merchants facilitated the exchange of commodity for commodity and surplus for comfort. Travel became a matter of comparative ease and men traveled far to display merchandise while the resources of a continent were converted into new wealth with which to purchase greater comfort, convenience, and opportunity. The standard of living constantly advanced and an ever-increasing proportion of the population entered the fields of industry, commerce, and finance. Cities grew and became the market places for agriculture. Inventive genius perfected machines to relieve more and more hand labor and to produce goods in greater volume. Working days became shorter and time and opportunity for recreation became greater. Education and travel created a desire for comfort, convenience, and refinements not dreamed of in earlier generations. Invention after invention revolutionized habits and customs. Electricity added to the length of the day by lighting cities and providing means of rapid, comfortable locomotion. Telephone and telegraph extended communication and nationalized industry, commerce, and finance.

"Refrigeration revolutionized the transportation and storage of food products and changed the living habits of the nation. Fruits, vegetables, and fresh meats were transported to distant markets, the production of the whole country was made available to the large consuming centers, and crops of seasonal production were offered to consumers throughout the greater portion of the year. The consumer came to accept unusual service and convenience as a matter of course and finally to demand more. Each new service and convenience drew additional people into the activities of distribution. Time-saving, convenience, comfort and satisfaction became the determining factors in the excellence of service. More and more facilities were created, more and more people were engaged, with a constant upbuilding of expense, until we have now reached a point where it costs more to distribute and serve than it costs to produce. Commodity values are lost in a maze of service costs, and time has come for a consideration of the fundamental problem of the economic distribution of the absolute essentials." [1]

Marketing and the Cost of Consumer Goods.—Many recent studies have been made which demonstrate the important part which marketing plays in the cost of consumer goods.

ANALYSIS OF CONSUMER'S DOLLAR

	Bread	Oranges	Furniture	Men's Suits
Primary production (raw materials)	30%	40%	23%	30%
Processing	12%	10%[2]	25%	38%
Marketing	58%	50%	52%	32%

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[1] Report of the Joint Commission of Agricultural Inquiry, 67th Congress, Part IV, pp. 3-4.

[2] Largely sorting and packaging.

The above figures, averaged for recent years from governmental sources, are typical of others which might be given. Costs of marketing will be discussed in detail in a later chapter;[3] the purpose here is merely to indicate the relative importance of marketing and of the other forms of production.

Marketing costs are relatively low for men's suits mainly because transportation charges for the finished product take a smaller portion of the consumer's dollar than for the other commodities listed; the other marketing expenses are very similar to those for the other goods.

It is probably a fair statement of the fact to say that at present from one-third to one-half of the price paid by consumers for the majority of goods goes to those who perform the marketing services.

Increasing Importance of Marketing.—There are indications that marketing is assuming more importance than formerly in relation to the other forms of production. For example, in 1870, 69% of all people gainfully employed in the United States were engaged in primary production, while only 10% were engaged in distribution (marketing including transportation). In 1920, 60% were employed in production and 25% in distribution. Estimates for 1928 indicate 57% in production and 28% in distribution. The remainder of the 100% in each case was engaged in professional services.

The reduction in the proportion of man power engaged in primary production is a sign of industrial efficiency, and it has come about coincident with a large increase in physical output from our fields and factories. One has but to glance into the past to be convinced of the great increase in the quantity of goods made ready for consumption each year. This increase is largely the result of better and greater use of mechanical power; the discovery of the principles of the lever and the screw increased man's productive capacity enormously, while the harnessing of steam and electricity to machines had an even greater effect. The old Periclean law gave to every Athenian the right to own five slaves; it is calculated that today every American has at his disposal the power equivalent of one hundred fifty slaves! This has permitted the increased output of goods per man employed.

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[3] See Chapter 20.

Lack of Labor-Saving Devices in Marketing.—Mechanical power has been applied to marketing to some extent. In transportation, as great an advance has been made in the use of power as in any branch of industry. Also, the use of conveyors in warehouses and stores, pneumatic tubes and bundle carriers, bulk handling of grain, automatic sorters and weighers, are all power adjuncts to marketing. Advertising is a sort of tool technique applied to selling, whereby the efforts of a vast army of personal solicitors are dispensed with in favor of a printing machine. "Self-service" stores have been tried especially in the retailing of food products as another device to reduce the selling expense. The most recent saving in man power in marketing comes with the introduction of selling Robots, or automatic vending machines. The recent increase of these machines has been astounding and there are indications of much further extension of their use in the future.

In spite of these illustrations of the use of labor-saving devices in marketing, the fact remains that power has not been applied in this field to the same extent as it has to primary production; probably it never will be. Much consumer purchasing is—always has been, and probably always will be—a matching of wits, a decision based on human contacts, a matter of changing fancy or prejudice. Human choices are more strongly influenced by personal solicitation than by any other force, and, therefore, as long as our present social order continues, we shall have a large element of personal salesmanship in marketing. Moreover, until forecasts of future demand are more nearly perfect than at present, human judgment will be required in the assembly of goods. It is on such grounds as these that one ventures the prediction that marketing will never become so completely automatic and machine-operated as manufacturing. If this prediction proves correct and marketing institutions continue to lag behind manufacturing in the increasing use of mechanical power, unit costs of marketing probably will continue to increase relative to manufacturing costs, i.e., marketing will become even more important relative to primary production.

Variety of Goods and Importance of Marketing.—There are other causes of the growing relative importance of marketing in our social economy. One of the most conspicuous is the increasing variety of goods which are offered to a bewildered public, often with little or no differences between offerings except a change in name or in package. Almost at the beginning of the industrial revolution Malthus suggested that changes in production might take place more rapidly than changes in the desires of consumers, as a result of the increased possibilities for production offered by the new system. As a result, more goods were likely to appear than would be consumed, not because of lack of purchasing power but because of lack of aroused desire. Malthus suggested that "demand creation" was a necessary adjunct to machine production in a dynamic society if gluts were to be prevented. The prediction has come true; today it is apparently necessary for producers constantly to change their offerings, and for them to use all imaginable forms of sales promotion schemes to induce people to pay a profitable price for the goods which industry offers. Goods are no longer sold in bulk, but are packed in fancy packages, often under a still more fancy trade name. These various brands must each be widely advertised in order to find sufficient outlets. It is estimated that nearly 1½ billion dollars are spent annually for advertising in the United States, while intensive salesmanship is even more costly and possibly more wasteful.

Style changes are rapid and revolutionary, often entailing sudden and large losses to individual manufacturers and dealers. What is lost on one line of goods must be made up on some other line if the dealer is to continue in business.

The Demand for "Service" in Marketing.—Still another contributing cause of the growing relative importance of marketing is found in the consumers' insistence on "services" of various sorts. Opportunity is desired for detailed comparison between many varieties and grades of commodities, for what seems "best" to one individual may not appear so to another. Convenient, attractive salesrooms are essential, but they are not enough. Goods must be delivered with the privilege of return. Rest rooms, eating rooms, meeting rooms, and garages must be furnished by every large city store, and patronage is often attracted to the stores having the most elaborate equipment.

Adequacy of Management in Marketing Institutions.—One further cause of the increasing costs of marketing relative to other enterprises is the failure of free competition to eliminate the inefficient operator. An outstanding characteristic of American manufacturing has been the growth of large-scale production. In these large concerns, authority resides in men of unusual ability and judgment. This fact has had much to do with the increasing efficiency of industry. To a large extent, in most industries, the less efficient firms—usually the smaller ones—have been forced out of business by the lower costs of the larger and better managed firms.

On the other hand, in the case of marketing—especially retailing, which is the most costly part of marketing—very small units of operation are still the general rule. In 1927, according to a survey made by the Department of Commerce for eleven representative cities, 95% of the grocery stores had sales of less than $50,000 a year; 89% of *all* kinds of stores had sales of less than that figure. As another illustration, a survey of the grocery trade in Minneapolis for 1924–1925 indicated that the stores which operated most economically sold $70,000 to $80,000 of groceries a year, while by far the most common size of store had sales of less than $30,000. Or again, in the recent Louisville census of food distribution it was found that the average sales from grocery and delicatessen stores was under $25,000, although sales per salesman increased and rent as a percentage of sales decreased until the volume was approximately $75,000.[4]

There are more frequent failures among small retail establishments than among large ones, as illustrated by a survey of retail grocery stores in Lincoln, Nebraska, for 1923. This survey showed that 37 out of 50 stores which failed during that year had very small sales, and none of those which failed had sales of over $50,000 for the year.

If marketing costs are to be held down in keeping with production costs, it is essential that control be placed in the hands of competent men. The chain store movement is an attempt in this direction; the movement is too young as yet to determine how successful it will be, but in spite of many "growing pains" it shows signs of progress in the right direction.

Improvements in Marketing.—It is therefore seen that there are many reasons for the heavy tolls taken for distribution. This is no indictment of middlemen; certain marketing functions [5] must be performed by some one. It would, perhaps, be still more costly if all producers were to sell direct to retailers or to consumers. It seems certain, for instance, that central stockyards and packing plants are more economical than a plant in every county where livestock is produced.

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[4] "Louisville Grocery Survey," U. S. D. C., Bur. of For. and Dom. Comm., Distribution Cost Studies No. 6, pp. 5–10.

[5] See Chapter 3.

"Direct" marketing has come in many lines; both large-scale and cooperative retailing appear to be gaining; integration and consolidation are daily occurrences. These changes, while not necessarily due to any desire to reduce marketing costs as such, being more usually a means of meeting competition, nevertheless may be significant means of improving distribution methods. Competition is often wasteful; no one would contend that a half-dozen wagons delivering milk on one street is the most economical method of distribution; it would seem much cheaper to allocate a certain section of the city to each distributor. Hence, consolidations of marketing institutions need not necessarily be viewed with any alarm. Many consolidations are taking place in marketing, as will be pointed out in Chapter 21. Hence marketing should be, and undoubtedly is becoming, somewhat more efficient.

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CHAPTER 3

MARKETING FUNCTIONS

Distribution of Goods Requires Many Services.—In the previous chapter it was pointed out that marketing costs make up a very large proportion of the total cost of consumers' goods. One reason for this costliness of distribution is to be found in the multitude of processes and services necessary to bring goods from producers to final consumers. While the marketing methods and marketing channels for the basic commodities differ widely—as is pointed out in later chapters—each requires certain operations common to all. For convenience, these various processes and services may be grouped into certain classifications known as "marketing functions."

Functional, Commodity, and Institutional Approach to Marketing.—A study of marketing may be approached from any one of three points of view. One may observe the various operations which are common to all marketing and group them into a series of major activities, known as "functions." This is commonly called the *functional approach* to marketing. Or, one may note all the details—and variations—connected with the distribution of each representative commodity. This is known as the *commodity approach* to marketing. Finally, one may study the market structure, i.e., the institutions and middlemen which perform the marketing functions. This is known as the *institutional approach* to marketing. These methods of approach overlap at certain points; for example, one cannot study the marketing of a specific commodity except in terms of functions and institutions, and it is equally impossible to study the efficiency of the market structure except in terms of the performance of the functions for specific commodities.

The functional is the most basic of these approaches, because the marketing functions must be performed for *all* commodities, regardless of the market structure. It is useful, however, to combine the three methods, in order to give a broader appreciation of marketing problems through a change in the point of view.

In this book, therefore, a background of marketing functions will be set up, against which may be displayed the marketing institutions and the methods followed in distributing specific commodities. In this way, the adequacy and efficiency of performance in any particular case may be treated. The functional background is essential also for purposes of comparison and contrast.

The Marketing Functions.—The basic functions performed in the marketing process are few in number. Each of these can be subdivided into minor activities or methods of performance—but to do so is to invite confusion. The classification below follows, with certain minor modifications, the suggestion of Professor Fred E. Clark.[1]

THE MARKETING FUNCTIONS

A. Functions of Exchange
    1. Assembly (buying)
    2. Demand manipulation (selling)
B. Functions of Physical Supply
    3. Transportation
    4. Storage
    5. Grading
C. Functions that Facilitate Trade
    6. Standardization
    7. Financing
D. The Ubiquitous (Universal) Function
    8. Risk bearing

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[1] F. E. Clark, *Principles of Marketing*, p. 11. See also L. D. H. Weld in *American Economic Review*, June, 1917, Vol. 7, pp. 306–318.

These various functions are discussed in some detail in later chapters. Here the purpose is to introduce each one briefly so as to present a unified background of the marketing process.

Functions of Exchange.—

Assembly. This term should be sharply distinguished from the physical assembling of goods. The latter is a matter of transportation and storage. The function of assembly, as here used, involves rather an act of judgment. It includes the seeking out of sources of supply and the decisions as to quantities and qualities of goods which shall be brought together at definite points. To illustrate, the typical retail hardware store carries several thousand different items in stock. These items are manufactured by numerous separate concerns. For each item several manufacturers may compete for the retailer's patronage. Some of the articles are purchased directly from the manufacturer, others from wholesalers or other middlemen. The decisions as to what goods to purchase, in what quantities, and from what sources, constitute the function of assembly, as performed by the retail hardware merchant. This illustration might be generalized to cover every marketing situation.

Good

The buying broker is the clearest example of a marketing agent who concentrates on performing the function of assembly. He keeps himself accurately informed concerning the sources of supply for one commodity or a group of commodities, on the one hand, and concerning the needs of specific purchasers, on the other. The prospective buyer is willing to pay the broker a small fee for getting him in touch with those sellers who will most advantageously furnish desired supplies, or the seller is willing to pay for the location of buyers. Some agency must perform this function; when a broker is not specifically employed for this purpose, the principal must either seek out his own sources of supply or demand (as the case may be) or employ a less specialized middleman to perform this function.

The concentration and dispersion of goods described in the following chapter is the result of the assembly decisions of the participants in the market. The purpose of such movements of goods is to provide adequate supplies at points where they are wanted. A decision is necessary on the part of some one, whether goods are brought together for further processing or manufacture, for storage and subsequent redistribution, or for immediate sale.

Demand Manipulation. This is the selling function. Producers must sell their goods in competition with the offerings of many others. This is accomplished by presenting ideas, or selling points, about a product or service to prospective purchasers. The process may be carried forward by personal solicitation or by some of the various forms of advertising or by both. After a buyer has once purchased a commodity, the satisfaction derived from its use is probably the strongest force in the control of his demand for it; if he likes it better than competing products, he will repeat his purchase, provided the price is satisfactory; if he strongly dislikes it, no amount of sales effort will cause him to buy again.

The manufacturer's sales agent, who undertakes to sell the product of a single producer against the competition of other producers and agents, sometimes performs only this function, just as the broker sometimes performs only the assembly function. Where a specialized agent is not employed, this function is performed either by some general middleman or by the manufacturer himself, for it must be performed by some one.

Demand manipulation is of importance in the existing social order because manufacturers lack complete knowledge both as to what people will desire at any moment and as to what competitors are going to offer. Individual producers often make a larger quantity of a specific product than the public will take off the market at the price set by the manufacturer or seller; if the goods are to be sold, some one must be *persuaded* to use them. A society may be imagined in which consumers asked only for what they want, without any urging on the part of sellers. In such a state, much effort now expended in sales promotion would be conserved, but some enjoyment would probably be foregone. In our present highly competitive society, however, demand manipulation has come to play a part of greater and greater importance. Advertising is today the king of merchandising, and has developed into a highly scientific means of influencing purchases.

Demand generally originates in one of three ways. In the first place, there is *direct demand* for goods to be consumed by the purchaser, as food, clothes, radios, and so on; such goods are desired for the satisfaction they give to the purchaser. For such goods the energy of demand manipulation is directed largely at the purchaser, or at the merchant who sells to him.

In the second place, industrial goods, as machines, appliances, raw materials, are desired merely as a means to an end. The demand for them is *derived* from the demand for the final product which results from their use. Therefore, much of the sales effort for industrial goods attempts to increase the consumption of the final product, thus indirectly affecting the demand for the industrial good itself. For example, the millers' demand for flour-milling machinery is *derived* from the consumers' demand for flour.

Finally, there is what is known as *reflex* demand. An electric power company realizes that more electricity will be used if there is more general ownership of electrically operated devices. Consequently, effort may be expended on selling electric trucks, washing machines, mangles, and what not. Demand is manipulated directly toward the device in question, although the end really desired is the increased use of electricity.

Functions of Physical Supply.—

Transportation. Two of the functions of physical supply—transportation and storage—are highly specialized and technical activities. Transportation is more universally performed by specialists who take no other part in the marketing process, than are any of the other functions. It is the means of bringing producer and consumer together in point of space. It does much to foster geographic specialization of industry together with cosmopolitanism in consumption.

Transportation charges are a large and important element in the total costs of many commodities. For example, nearly one-third of the delivered wholesale price of oranges shipped from California to eastern points goes to the railroads which haul the fruit.

Much thought and money have gone into the planning and construction of transportation facilities, each new development of which has brought a change in the established channels of trade. The opening of the Panama Canal has modified the competitive relations between certain producing areas; if the Great Lakes waterway is opened, other changes will occur. The motor truck and the private automobile have also caused a realignment of trading areas and some changes in marketing practices, as will be pointed out later.

A peculiar circumstance connected with the transportation function, particularly as applied to rail transportation, is the fact that it is controlled to a marked degree by government. This control has developed for two principal reasons: (1) transportation is universally important. That fact alone, however, would not justify governmental interference with the system of automatic exchange-cooperation; the distribution of bread is universally important, but it is not regulated by the government to the same extent. (2) The physical nature of the enterprise readily lends itself to monopoly control and monopoly rates. The high cost of initial construction prevents competitors from entering the field freely, thus making possible higher rates than could be charged if competition were more easily started. Private monopolies and monopoly rates are out of harmony with a system of individual exchange-cooperation; consequently, the government has undertaken to establish charges which permit only a "fair rate of return." Furthermore, railway costs are such that competition is usually of the cut-throat variety. Regulation has, therefore, been necessary.

STORAGE. Storage, or warehousing, is important in the marketing of nearly all commodities. It is through the performance of this function that production and consumption are brought together in point of time, and that the seasons of nature, and of supply and demand, are offset or nullified. Some of the major economic services of storage are the following:

1. Storage insures a constant supply of *seasonally produced* goods. Most agricultural products, for example, are either entirely or largely produced during a few months of the year, necessitating many months' carrying in order to make the products available throughout the year.

2. Storage permits *seasonally consumed* goods to be produced regularly during the whole year. Calendars are distributed mainly in December and January, although the manufacturers commence their preparations in the preceding February. In that manner, storage serves to iron out irregularities in production. It prevents the high peak of enforced production under the pressure of overtime work, on the one hand, and modifies the opposite extreme of the low point of industrial output, on the other. With most manufactured goods, the demand is seasonal and production can be maintained only in connection with storage. Costs of manufacturing are thereby lessened, by preventing expensive rush work and by permitting more specialization in operations.

3. Storage irons out irregularities in marketing. A certain market may receive more of a commodity than can be immediately sold at a profitable price. Adequate storage facilities prevent "dumping" the products at a loss. Further, most dealers and manufacturers occasionally purchase far beyond current requirements in order to guard against a shortage or in order to gain from expected price advances. In any case, storage facilities must be available.

4. Storage irons out fluctuations in prices, throughout the year, and from year to year. The sale of large stocks at one time often causes prices to drop sharply. By storing the goods and feeding the market at a more regular rate, the range in prices may be decreased materially. Also, the demand for goods to be put into storage during the months of heavy production tends to raise the level of prices at that time; later, when production is small, the supplies of storage goods put on the market tend to prevent unduly high prices.

Non-perishable goods are frequently carried over from a season of heavy production in the anticipation of higher prices later. Wheat, for example, is seldom all sold during the crop year it is produced. "Orderly marketing" programs, with the aid of adequate storage facilities, are thus often resorted to in order to iron out price fluctuations from year to year. An extreme example of such a procedure is that of the Brazilian coffee valorization scheme.

5. Storage facilities permit extensive grading and "mixing" of certain raw materials, such as wheat. As will be pointed out in a later chapter, "mixing" of grain is an important activity of the terminal grain elevators.

6. Storage facilities serve for the curing, ripening, and preservation of many commodities. Lumber is often stored for long periods in order to allow it to "season"; tobacco is "cured" in large warehouses in order to give it the right quality; many fruits are picked green and allowed to ripen in storage; perishable products are often kept for certain

periods in specially constructed plants. In the latter case, mechanical refrigeration has become of increasing importance. Cold storage warehouses, which were formerly cooled by a freezing mixture of crushed ice and salt, are now using liquid ammonia and a brine made of calcium chloride. The temperature can thereby be controlled more accurately, and chilling or freezing of the products is better performed. Such mechanical refrigeration permits perishable food products, such as meat and eggs, to be kept in a wholesome and palatable condition for periods of six to twelve months. Cold storage has also made it possible to ship meat and other perishables across the equator in specially constructed refrigerator containers. Southern produce reaches northern markets in good condition during the off season, so that fresh goods may be had throughout the year. Modern storage methods have thus revolutionized marketing methods for perishable products, and have also had a profound influence on consumption habits.

Some warehousing organizations undertake others of the basic marketing functions. They may reship, especially when use of "pooled" cars is possible; they may lend money directly on the stored goods; they may conduct auctions, or otherwise exhibit and sell goods stored with them. On the whole, however, warehousing is a specialized undertaking, limited rather closely to the storage function.

In a limited and non-technical sense, storage is performed by every organization connected with the physical side of marketing. Whenever goods are held in process or for sale, they are held in storage. Storage, in this sense, is an incident in manufacturing, wholesaling, and retailing. Historically, much of the storage of merchandise has been undertaken by wholesalers, this being one principal function performed by them. More recently, however, both public storage of general merchandise and particularly cold storage of perishables have become highly specialized activities.

The importance of public warehousing is further evidenced by the interest of the government in storage activities. Public warehouses are nearly as completely regulated as are transportation agencies.

Grading. This function consists in the division of a commodity into units of recognizable quantity and quality; it can be performed only after the next function—that of standardization—has been carried far enough to establish classes into which the commodity may be graded. For example, a carlot wholesaler may purchase a carload of boxed apples which he sells to the retail trade in lots of 5 to 25 boxes; or a hardware wholesaler may buy shears by the gross, repackage them, and pass them on to the retailer in individual boxes, thus changing (grading according to) the unit of quantity. A coal dealer may buy run-of-mine coal which he sorts into a series of sizes, or a country grain dealer may buy wheat as it comes from the field and grade it according to the color of kernel and weight per bushel, thus separating the ungraded whole into units of standard quality.

Grading is generally undertaken either by producers or by merchants. It is not a specialized function; that is, few special organizations have grown up to handle this function alone.

Functions that Facilitate Trade.—

Standardization. Standardization is closely connected with grading; it forms the basis upon which grading proceeds, by defining the tests to be applied. Its main objects are to make the exchange of goods easier and to insure more complete satisfaction to both parties to a bargain.

The degree and type of standardization determine in part the method of sale. Goods are sold by one of three basic methods, namely, by *bulk,* by *sample,* or by *description.* If sale is to be either by sample or by description, there must be a reasonable degree of standardization, so that the buyer will know that the goods delivered will be like the sample or the description. If all goods could be purchased by description, much time would be conserved that is now spent in the inspection of different offerings.

Goods may be placed in one of three groups based upon the degree and method of standardization possible:

1. Goods conforming to arbitrary standards set up by governmental agencies or trade associations, in accordance with which the products of an entire industry may be graded. This development is especially marked with farm products. For commodities such as wheat, the government standards are followed throughout the United States; the grading may be fairly precise, so that selling by description is possible. Consumers know fairly accurately what they will receive when buying a particular grade of the product.

Some manufactured goods which are used by industry in further processing, such as bar copper and many steel products, are graded according to arbitrary standards set up by trade associations. Even some consumer goods are so graded, as for example, U.S.P. drugs.

2. Goods conforming to standards established by manufacturers themselves. Such goods as nails, bolts, and other industrial supplies, are ordinarily manufactured by machines and are standardized in the process. Even in these cases, however, identity of units results only when the raw materials, out of which the machine fashions the products, are graded. Trade associations are doing much to further the standardization of such commodities.

With most industrial goods, every unit is essentially similar to every other unit produced by the same machine. Quite often, however, there are variations of more or less importance between the products of competing manufacturers. In the absence of common and like standards, the consumers cannot readily rank the several offerings, but must match their limited knowledge and experience against the blandishment and persuasion of competing salesmen. Individual, non-comparable standards, therefore, tend to prevent complete freedom of competition. This applies also to innumerable consumers' goods, particularly where style is an important factor in selection.

3. Goods which are essentially unstandardized. This group is not as large as might be expected. Ore as it comes from the mine, and grain as it comes from the field may be sold ungraded; standards are available, however, which would permit fairly accurate grading if it seemed expedient. For other products, such as potatoes, the government has promulgated certain standards, usually based on size, which would permit at least partial grading. The lack of understanding of the implications of such standards on the part of consumers, however, has prevented any widespread adoption.

On the other hand, much produce, such as carrots and lettuce, and many manufactured consumers' goods, such as women's hats, are essentially unstandardized. With such goods, therefore, buying by inspection is the only method feasible.

FINANCING. Most goods which are consumed today have been a long time in the making; the processes of production are usually extremely roundabout. At all points in this production process, it is necessary that a large share of our productive resources be devoted to maintaining a stock of goods, although such goods are not used in satisfying immediate wants. For example, the leather in shoes bought today may have been on a Montana steer five years previously. In the meantime, tanners have put much effort on the processing of the hide, and they need also, at all times, to carry a reserve of leather on hand; the factory devoted to making the shoes needs to keep complete stocks of leather, of thread, and of other supplies, considerably in excess of current requirements. In addition to the cost of carrying these stocks of goods—which might be called contingent reserves—much outlay for labor, machinery, and buildings is necessary. Wholesalers and retailers also need to carry contingent reserves. Stocks of goods on hand must at all times be sufficient to take care of ordinary requirements; demand for most products is not so constant that it may be accurately anticipated.

Reserves are, therefore, essential throughout the marketing chain. All add to the costs of carrying the goods forward from producers to consumers, and these costs must ultimately be covered by the selling price of the products. It is the monetary part of the process of carrying these reserves which is called financing; the physical part is, of course, storage.

Fortunately, there are people in our modern society who have funds which they do not care to expend for immediate consumption, but which they are willing to devote to the carrying of contingent reserves upon the payment of a certain return. Our financial organization provides the means for transferring the use of such funds to the industries which need them, so that stocks of goods and equipment may at all times be carried in excess of current requirements.

It is not only the direct expense of carrying these reserves which adds to the costliness of marketing. Ours is a dynamic society, and changes are frequent and often quite extensive. New products and new styles take the place of old, which means that there is also a considerable risk of loss in carrying large reserves. Stocks bought in the anticipation of being turned at a profit may need to be sacrificed at a loss because of style or price changes, or because of deterioration and spoilage.

A special method of financing *consumer* purchases has become increasingly important in recent years. A great volume of goods is sold at present to consumers on an *instalment* plan. For example, it is said that 85% of the automobiles and 80% of the furniture are sold in this manner. Much jewelry, clothing, radios, and other consumer goods are also paid for in monthly or weekly instalments. Since the average retailer cannot finance extensive time purchases, special finance companies have come into being to relieve him of the burden.

The Ubiquitous or Universal Function.—

Risk Bearing. Risk arises out of uncertainty, and accompanies the ownership of goods. The marketing process is filled with uncertainty from beginning to end; no market situation is entirely free from it. Risks are more prevalent in marketing than in primary production, because marketing is intimately affected by the actions of people, and actions of people cannot, as yet, be anticipated with sufficient accuracy to eliminate the uncertainty of their results. In designing a bridge, the stress and strain is anticipated, the strength of materials is measured, allowance is made for contraction, expansion, lateral sway, and so on. If techniques are applied properly, the result is certain. But as yet there is no technique that will forecast the color of next season's dresses! So important is this function in the marketing process that considerable attention will be paid to it in subsequent chapters.

Many of the points made in this chapter will be presented in more detail later. The purpose so far has been to impress upon the student the fact that marketing involves more fundamental things than the giving and taking of orders for goods, and, further, that middlemen who perform certain, or all, of these functions are engaged in useful and necessary activities. The elimination of middlemen does not eliminate functions. The task before the student of marketing is rather to determine whether improvement can be found in the methods of performing the functions.

CHAPTER 4

SOME CONCEPTS OF MARKETS AND TRADE

Two Distinct Phases of Marketing.—This is an age of *exchange.* Goods and services useful in further production tend to pass into the hands of those persons or firms who can use them most advantageously; goods and services ready for consumption go to those users whose effective demand[1] is the greatest. In bringing about the advantages of exchange, there are two parts or phases of marketing. First, there is a *physical movement* of goods from the place where they are produced to the place where they are consumed, and, secondly, there is a *change of ownership* of goods. The former may involve considerable time and a large outlay of money, of labor, or of both. Railroads, steamship lines, warehouses, wholesale and retail stores, are all directly concerned with this phase of marketing. Thus, raw rubber is sent across the seas in steamships, stored at seaports, sent by rail to various interior factories in this country, to be made up into different products. These products then go to wholesalers' and retailers' warehouses before finally reaching a consumer, perhaps fifteen thousand miles away from the place where the raw rubber was originally taken, and perhaps a year or two later. A tire manufacturer in this country might possess his own rubber plantation and sell direct to consumers, in which case only one change of ownership would occur during the entire process. Likewise, oranges grown in California may be packed and moved all over the country without any change in ownership until they finally reach the point at which they are consumed. Hence, the physical movement of goods may be quite extensive without involving the other phase of marketing.

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[1] See Chapter 8 for definition of effective demand.

On the other hand, change in ownership may take place without any physical movement. The selling of real estate obviously involves only a change in ownership; on the grain exchanges, titles to wheat may be sold a dozen times while the wheat actually reposes in some elevator.

Again, these two parts of marketing may be closely related, as when a retailer sells an article across the counter in exchange for cash. Thus, the two phases may be closely associated or quite distinct, either one happening without the other. Marketing, in the full sense of the word, must involve the change in ownership; physical movements merely facilitate this change or make possible the use of the commodity by the new owner. All rights, privileges, and responsibilities, either of use or of further sale, attach to ownership and are passed on with change in ownership. In other words, the one essential to marketing is *exchange*.

Some Elementary Principles of Trade.—As just pointed out, the essence of marketing is the exchange of ownership of goods. In order to appreciate what is involved in such change of ownership, and in order to avoid many popular fallacies commonly expressed in connection with the solution of our economic problems, it is necessary to understand the following elementary principles of trade. Problems of tariff policy from an economic standpoint, and the real advantages of foreign trade, for instance, can be discussed intelligently only by a realization of the implications involved in trade. These principles are presented in a simple form at this point to avoid possible misunderstandings later.

1. Each person tends (1) to work at a limited number of tasks, (2) to sell the product of his labor, and (3) to buy the other things which he needs. Moreover, each area or country tends (1) to produce only a few things, (2) to sell its surplus

of these, and (3) to buy with the proceeds the other things needed. The first part of the principle—*specialization applied to persons*—gives rise to exchange of ownership as an almost universal occurrence in present-day society. The second part of the principle—*specialization by areas and countries*—is responsible for the present importance of physical movement of goods.

2. The decision as to what things will be produced and what will be bought rests upon the principle of *comparative advantage*. Under this principle every person, firm, or community undertakes those tasks and operations which yield the greatest total return. The man on the street utilizes this principle when he buys those things which he can buy more cheaply than he can make them, and when he produces those things which would cost more if he bought them. The corporation utilizes this principle when it hires or buys those parts of its finished product which it can so obtain more cheaply than it could make them. A country operates in line with this principle when it exports those products which are lower in price within its borders than elsewhere and imports those which are higher in price at home than abroad.

In each of these cases—the person, the corporation, or the country—a little thought will make it clear that the cost of any one operation includes the giving up of some alternative task. For illustration, if an insurance salesman polishes his own automobile—which task he might have hired done for $1.50—and by so doing loses the sale of a policy on which his commission would have been $25, the cost of his polishing becomes the difference between the two, or $23.50, plus the cost of the polish he used. Or, consider the farmer who raises hay for his livestock, which would have cost $100 to buy. If on this land he might have produced potatoes worth $200 (above the extra labor costs), the cost of the hay becomes $100, plus the costs of raising and harvesting the hay. Such considerations of the comparative advantage of various undertakings determines specialization of persons and of communities. This principle is referred to again in the chapter on international marketing.

3. All trade is in reality an exchange of goods and services for other goods and services. It is true that money has to be paid in exchange for goods in a store; but the money was itself obtained in a trade, either against goods or against personal services. Something has to be traded in the first instance—goods or labor—to get money. The money as such is of no interest to anyone, for it can serve neither as food, clothing, nor shelter—and these are the three elemental wants which we must satisfy. Money is but a convenient mechanism—a go-between—for the bringing about of exchange of goods and services.

4. Goods are sold as a means of getting other goods. No one is really interested in selling goods except as the sale provides the purchasing power—money—to acquire something else for consumption. Consumption, the satisfying of one's personal wants, is the aim and end of all economic activity; production and exchange are but means to that end.

It follows as a corollary that total consumption must be equal to, and cannot exceed, total production. Of course, trade is not direct, but is multi-cornered; that is, many people are exchanging amongst themselves, without any exact balance until *all* transactions are taken into account. If some of the people who have received money in exchange for goods should actually hoard that money, there would be a lack of complete balance of production and consumption; if carried far enough, there would be what the business world calls a "buyers' strike."

5. In any trade, the value of the goods and services given must be equal to the value of those received in return. For present purposes "value" may be defined as the amount of money that will be given for a unit of commodity or service. Since every sale made by one person is a purchase by some one else, it follows that the total amount of money taken in must

exactly equal the total amount paid out. And so for the entire trade of society, the value of sales just equals the value of purchases.

6. The benefits of trade are not to be found in the difference in money value of goods sold and those bought, but rather in the increase of human satisfaction resulting from the exchange. Since the shoemaker cannot wear all the shoes he makes, and since the peach grower cannot eat all the peaches he grows, they can each get more enjoyment out of life if they exchange some shoes for some peaches. The amount of money involved has nothing directly to do with the amount of enjoyment, for the money is neither eaten nor worn; but after the exchange each is able both to eat and to be shod.

7. The benefits of trade must be mutual—that is, they must be shared in by each party to every exchange; but they need not be equal. We now distinguish between the "value" of the goods exchanged and the "benefits" resulting from the exchange. No one would trade unless he confidently expected to benefit thereby—that is, unless he expected greater personal satisfaction from the new possessions than he could expect from the old; but, on the other hand, people generally will not forego a benefit from an exchange just because the persons with whom they might trade will benefit still more.

8. In practice, of course, trade is divided into two parts, the sale of goods for money, and the purchase of other goods with that money. It is the completion of both of these transactions which is really important, for that gives us goods with which to enlarge our enjoyments.

Popular Disregard of These Principles.—These elementary principles are overlooked by some seasoned business men almost constantly. For example, there is a common popular feeling that the value of our foreign trade arises from the fact that it serves as an outlet for our surplus goods—that is, for those goods which cannot be sold in this country at a price which is attractive to the producer or seller. If that were the sole purpose of foreign trade, we, i.e., the selling nation, would get money in exchange for the goods we had produced and sent abroad. As has been pointed out, we could neither eat, wear, nor live in, that money. Moreover, we should have sent away some of the things we might have consumed.

In contrast, the real advantage of foreign trade comes when we receive other goods in exchange for the ones we send out; goods which we cannot produce, or which we cannot produce so well or so cheaply as we can obtain them through trade. With such trade, we have the benefit of greater total human satisfaction.

The same principle applies to domestic trade. The welfare of a community is not enhanced by sending out goods unless other goods are received from somewhere in return. Such return of goods may result, of course, either from a direct or from a roundabout trade. The popular slogan, "Buy in your own town and keep your money at home," is one of the fallacies based upon the assumed benefits to be derived from accumulation of funds (money) within a community. While there are valid arguments in favor of trading with local merchants, doing so merely in order to keep money at home is not one of them.

Certainly there are many cases in which individuals undertake to save money by performing certain tasks themselves when they could more profitably continue with their specialty and either buy or hire the services in question.

Concepts of the Term "Market."—The term "market" is so generally used that it might seem to require no explanation. The very fact of universal usage has resulted, however, in different meanings attaching to the word. These common meanings may be separated into three fairly distinct concepts: (1) A market is a place where goods are bought and sold. This is the *geographical* concept of a market. It may be expanded to include the area surrounding the market place, from which goods are brought for sale, or to which they are dispersed after sale. (2) It is also a series of individuals, firms, and organizations which serves to pass a given sort of good from its maker or producer to its user or consumer. This is the *structural* concept. (3) Finally, a market consists of the conditions and forces which determine the demand for, and the supply of, any good or service and which result in a price. Every exchange is at a price and price making is, in a very real sense, the central problem of economics. Consequently, this third concept of a market—which may be called the *price-making* concept—is more important than either of the other two. Also, it includes both the others, for the geography of the market and the institutions which compose its structure are among the forces which determine prices.

Market Places and Areas—The Geographical Concept.—A market in the geographical sense may be either a point at which goods are received from a surrounding territory, or a series of points to which goods are distributed from a point of production. For illustration, any large metropolitan center, like the Twin Cities, is a market in each of the following senses:

1. It is a receiving center for locally grown produce which is consumed in the city.
2. It is a receiving center for those products of the surrounding area which need to be processed within the city before they are consumed.
3. It is a receiving and forwarding center for those surplus products of the surrounding area which are distributed to other consuming centers.
4. It is a receiving and distributing center for many forms of consumer goods from all parts of the world.
5. Some raw materials may be received from other areas to be manufactured in the metropolitan center, either for consumption within it, or for dispersal to the surrounding area.

6. Some raw materials and supplies may pass through the center en route to production plants in the surrounding territory.

If the market area is to include all of the territory reached by the Twin Cities, to continue the illustration, in both its receiving and its distributing functions, it will extend on the one hand to the farthermost points from which any wheat or livestock comes for processing, and, on the other hand, to the limits to which Minneapolis flour and South St. Paul cured meats are shipped. In point of fact, it will be even more extensive, for road machinery is shipped from Minneapolis to South America, while much coffee is consumed here which was grown in Brazil.

This illustration emphasizes the fact that geographic markets overlap and intermingle. Moreover, market areas are very different for different commodities. South St. Paul is a receiving market for livestock from the territory stretching west to Idaho and north well into Canada. For fluid milk, on the other hand, an area with a radius of about 40 miles supplies the Twin Cities. Such differences are generally inherent in the nature of the commodities.

For most commodities, market centers compete with each other. The only exceptions are commodities which do not bear shipment because of their physical nature, or whose transportation costs in proportion to their price are so high as to make shipment uneconomical.

Competition is stable enough that the market area for any specific product is fairly definite at any one time, although it may differ for different grades of the product. It is very likely to differ from day to day or from year to year, especially if any change occurs either in the cost of production or in the cost of transportation. For, in the last analysis, relative prices at competing points, together with relative transportation costs between the points, determine the outlines of geographical markets.

Market Organizations—The Structural Concept.—Marketing, like all phases of business activity, has undergone many and far-reaching changes during the past few centuries. A study of these changes reveals the important fact that trade channels and market structures are constantly modified to meet the prevailing economic and social development—that is to say, to reflect more accurately the price-making forces in the competition between individuals and areas.

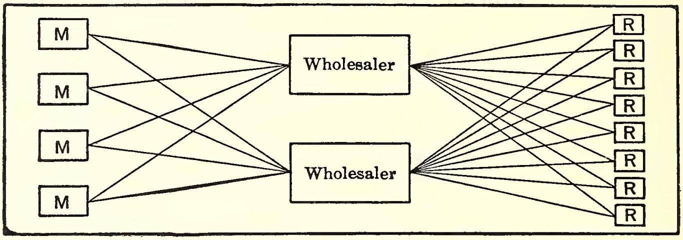
Beginning with the earliest times, before the advent of monetary standards and mechanical transportation, few goods entered into commerce. Economic activity was largely on a self-sufficing basis, each family or tribe producing enough to satisfy its simple wants. Some trade was carried on at times by means of direct barter. This stage may be called the *self-sufficiency* stage.

With the coming of monetary standards and with the growth of population and political freedom, specialization and division of labor gradually superseded self-sufficiency, and the exchange of goods took place on a small scale, as between individuals and as between political units. Marketing during this second stage was mostly direct, one producer exchanging his surplus for that of another producer, without the intervention of any middleman. This stage, which may be called the *direct marketing* stage, is typified by the medieval fairs, where producers met to exchange products. In many European countries, the centrally located villages are still the scenes of weekly "fairs," the farmers from the surrounding territory bringing their produce to the village square, in push carts or otherwise, and offering their wares on certain designated marketing days.

With the growth of mechanical transportation on land and sea, a third stage in marketing was ushered in—that of *indirect* marketing. Specialization and division of labor soon came to be the accepted mode of economic life. The result was that production was carried on for the market, each person depending upon one or more middlemen to get the product to the ultimate consumers, as well as to bring raw materials and other goods in return. So producers and consumers became separated in time and space by a market organization, and the dilemma of adjusting production to consumption came to be a problem, the solution of which has been wrestled with for decades by producers, consumers, politicians, laborers, and all other classes, with varying success. Furthermore, our economic society became a tangle of interrelated business enterprises, each failing or prospering with the tide in fortunes of the others.

A comparison of present-day marketing structures with those of the beginning of the century shows large and significant changes. There is evidence on every hand of a reversal to a more direct method of marketing in many lines. This change may be attributed to three causes: (1) Costs of distribution have grown increasingly high for many products, with the result that changes have arisen out of sheer necessity, in the effort to keep consumer prices down and thus maintain consumption. (2) The growing intensity of competition has led to new and often more ingenious ways of reaching the consumer. As a result of this keen competition, there has been a change from convenience goods sold in bulk to specialty goods sold in packages. Specialty selling depends for its success upon advertising, and in order to reap the full benefits of advertising, indirect channels of trade must give way, in part at least, to more direct ones. (3) Many manufacturers desire to retain control of their product until it reaches the consumer's hands, both in order to control prices and to get the full benefit of national advertising. Hence, manufacturers' retail branches, direct selling to retailers, and other direct methods of reaching consumers, have developed.

The following graph illustrates the tendency, just referred to, for the marketing channels to become more direct. It will be noticed that the assembly function is performed by manufacturers, wholesalers, and retailers in the conventional method of marketing, while it is performed only by the manufacturer *a*—CONVENTIONAL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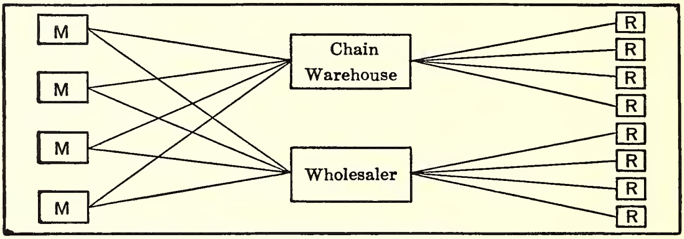
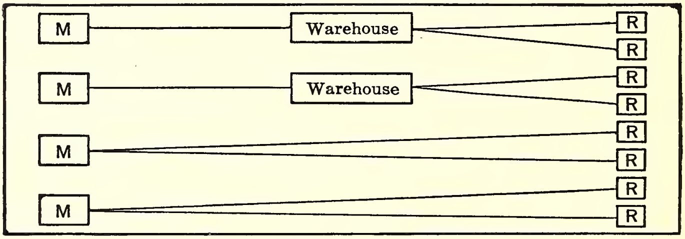
R

b—CHAIN STORE AND VOLUNTARY CHAIN


M
M
M
M
Chain Warehouse
Wholesaler
R
R
R
R
R
R
R
R

c—MANUFACTURER'S CHAIN


M
M
M
M
Warehouse
Warehouse
R
R
R
R
R
R
R
R

M=Manufacturer. R=Retailer.

Figure 2. Marketing Channels for Consumer Goods

in the case of manufacturers' chains. Moreover, the physical distribution of goods is less complicated in the latter case.

The exact structure of the market at any given time for a specific commodity depends on many things, such as the nature of the commodity itself, the state of competition in its production, the nature and location of its consumers, and so on. A more complete picture of the present marketing structure is delayed, therefore, until the classification of commodities for marketing purposes has been discussed.

The Price-Making Concept.—The scope of many markets is the entire world. This is probably true of rubber, wheat, tea, coffee, cotton, silk, iron, copper, and most of the metals. The price paid to the North Dakota farmer for wheat is closely related to the price of flour in the capitals of Europe. Liverpool may be spoken of as a world market for wheat. What is meant by this statement is that Liverpool, which is the largest European receiving market for wheat, is the place on which the dealers of the world focus their attention. Because there is a close structural and geographical linking of the wheat markets of the world, the price of wheat in Liverpool reflects conditions of supply and demand throughout the world. Any change in that price must result from a change in the dealers' estimate of either supply or demand. Such change of estimate may arise from a governmental forecast of crop, a report of frost in Australia, a failure of the German potato crop, a threatened revolution in Russia, or an unexpected drop in the stock market.

In the world markets—where the market structure furnishes rapid communication—market information, conditions, and relationships are promptly reported and price adjustments are quick to respond. But world markets are not essential to the price-making concept. Even in the most local of markets, price is set in accordance with the joint interpretation of supply and demand by buyers and sellers. Every purchase or sale, offer or bid, change or rumor of change regarding a commodity, is part and parcel of the market for that commodity. It is in this sense that the market controls the destinies of the world, for it is price which regulates production and consumption.

A Perfect Market.—It is possible to define a theoretically perfect market in accordance with each of these concepts. From the standpoint of price making, a perfect market involves complete competition. Competition—the independent endeavor of two or more persons to obtain the business patronage of a third by offering more advantageous terms—may be said to be complete when the following conditions are fulfilled:

1. On both the buying and the selling side there are two or more persons or firms acting independently.
2. Equal information concerning supply and demand is available to both buyers and sellers alike.
3. Action is rational on the part of both buyers and sellers, that is, action is designed to be in their own best interests.
4. There is substantially equal ability on the part of all buyers and sellers alike to trade at the most advantageous moment, or to postpone action until a more favorable time.

Under such conditions of competition, the price agreed upon would accurately measure the relative position of supply and demand, subject only to the errors of human judgment in interpreting trade information and personal interests.

A perfect market from the standpoint of market structure would be that organization which provided:

1. The most extensive and efficient means of gaining information and disseminating it among all buyers and all sellers.
2. A satisfactory and convenient place for buyers and sellers to meet, show their wares, make known their wants, and transact their exchanges.

3. Opportunity for economical storage of goods until such time as they are desired for consumption.
4. Operation of all the activities of exchange at the lowest possible cost.

A perfect market in the geographical sense would involve the linking together of various points of production and consumption by systems of communication and transportation which are as adequate as human ingenuity and production economics can justify. The full comparative advantage arising out of specialization by areas can be realized only when (1) information is freely exchanged between the people in the several areas, and (2) there is adequate opportunity for the physical movement of goods from one point to another.

The realization of a "perfect market" depends upon many things, such as the type of market, the good itself—whether it is graded or ungraded, perishable or non-perishable—the legal status of exchange in the place in question, the number of traders, and so on. In some markets there is competition between buyers but not between sellers. In other markets the reverse is true. Some of the conditions which preclude perfect markets are discussed in Chapter 6.

Two Types of Physical Movement.—The market structure generally provides for two types of physical movement of goods in the process of linking areas and countries together into a related series of markets. The chart in Chapter 2 indicated a market organization at several points in the progress of goods from producer to consumer. These organizations serve somewhat different purposes. Some act as concentrators of raw material for large-scale consumption by industry; others disperse the processed goods from these concentration points to small-scale consumers. These two types of physical movement of goods, *converging* and *diverging,* are illustrated in the accompanying graph.

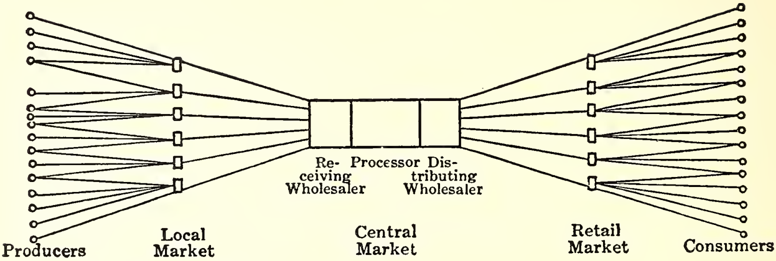


Figure 3. Physical Movement of Goods

The above generalized diagram illustrates the two movements; the concentration of wheat, for example, first in the local, then in the terminal elevators and mills; and also the dispersion of the processed commodity, flour, to a few wholesalers, to a great many retailers, and finally to a vast group of consumers. The first points of concentration of raw materials are usually referred to as "local markets" or "producers' markets." The final places of concentration are referred to as "central," "wholesale," or "primary" markets. In the dispersion movement, the goods may successively travel through a wholesale and a retail, or consumers', market. These various market organizations were spoken of earlier in the chapter as the market structure: the price relationship between them will be discussed later in Chapter 10.

The picture just presented of the market structure is greatly oversimplified. Any commodity on its way from producer to consumer may travel any one of a multitude of courses. The existing complexity of the actual market for various products may be traced in the diagrams found in Appendix A. These diagrams point out the intricacy of our present economic organization and the exhaustive analysis which would be necessary to cover completely the physical movement and exchange of goods.

CHAPTER 5

CLASSIFICATION OF COMMODITIES

Three Groups of Commodity Characteristics.—The specific methods and problems of marketing differ greatly for different commodities. As already pointed out in Chapter 4, market areas vary greatly for different goods. Moreover, the structure of the market varies between commodities. For instance, shoes are more often sold by manufacturers directly to retailers or even to consumers, than is sugar. The marketing of fresh meats and eggs requires the services of somewhat different middlemen than the marketing of farm machinery. The problems in marketing Portland cement are very different, in detail, from those in marketing fur coats. Trade channels—that is, the agencies or functionaries through whose hands the product passes—differ between these several cases.

Much of the difference in market structure or trade channels is accounted for by the nature of the commodity itself. The commodity characteristics which influence marketing may be grouped for convenience into three major classes: (1) physical characteristics, (2) the use of the commodity, (3) methods of production. Each of these classes may be subdivided in turn, and each is independent of the other two. The present chapter is devoted to a discussion of the influence of these characteristics on marketing methods.

Physical Characteristics.—

PERISHABILITY. Perishability may be evidenced either by fragility, by tendency to decomposition, or by deterioration of appearance. Three degrees of perishability are commonly recognized:

Non-perishable commodities are those which do not deteriorate, but may be held in ordinary storage from one year to another without physical loss. Wheat, coal, and lumber are illustrations of non-perishable goods. Non-perishable goods are frequently held in storage for a period in the expectation of an increase in value at some subsequent time. Thus, wheat is frequently held over from one crop year to another, because the owner anticipates a higher price in some future period. Other non-perishable goods actually improve in quality with storage; lumber is often stored for considerable periods in order to allow it "to season"; tobacco may be held in order that it may cure and ripen slowly.

Certain non-perishable goods may not, economically, be carried over from season to season. Automobiles, women's gowns, and other items are subject to style changes and subsequent loss in value; such goods are generally put upon the bargain counter, rather than carried over into another season. In this particular way, style influences marketing much as does physical perishability. In most cases the problems of marketing non-perishable goods are chiefly concerned with the *time* of selling.

Semi-perishable goods are those which are subject to decomposition or deterioration of appearance if carried over from one season to another. Potatoes illustrate this class of commodities. Semi-perishable goods—usually seasonally produced—are stored, most frequently by specialized storage agencies, in order to insure an even flow into consumption channels. These goods generally must be sold before another season's supply reaches the market. The problems of marketing such goods are chiefly concerned with the *rate* of selling.

Perishable goods are those subject to decomposition and deterioration of appearance in a short period of time after they are produced. Many such goods may be stored only a few days. Milk, strawberries and lettuce are highly perishable commodities. Since such goods cannot be stored for more than a few days—or hours—they must be sold at whatever price they will bring. For that reason, successful marketing of perishables depends upon proper planning of the amount which shall be sent to each geographic market; the marketing problems are, therefore, chiefly concerned with the *place* of selling. The assembly function, in this case, is of particular importance, because there is little chance to correct mistakes once made.

Thus it is seen that the degree of perishability influences the performance of the functions of exchange, of physical supply, and of risk; it determines also in part the trade channels.

PERIOD OF USEFULNESS OF THE COMMODITY. As pointed out in Chapter 3, a method of financing which has become increasingly important and popular in recent years is that used in selling goods on an instalment plan. For purposes of analyzing instalment selling, goods may first be classified on the basis of their use, i.e., as consumption goods or as goods to be used in further production. Consumption goods may again be classified on the basis of the period over which their want-satisfying powers are given up, i.e., as long-time, durable goods, or as immediate and transitory goods; pianos, radios, and automobiles are examples of the first class, while food illustrates the latter. Instalment selling is applicable only when goods render their usefulness over a period at least as long as, or longer than, the period covered by the instalments. In recent years, however, instalment selling has entered fields to which the above principle hardly applies. Much cheap clothing may at present be purchased with a small down payment and monthly or weekly instalments. It may be seriously questioned in many such cases whether the "enjoy-it-as-you-pay" policy is valid.

Durable consumer goods, on the other hand, usually have the qualities necessary to warrant instalment selling. The satisfactions are derived over a long period relative to the time necessary to complete payments; the value is comparatively high; they are reclaimable, and usually have a resale value equal to any unpaid balance if the seller repossesses them promptly.

The same reasoning applies to the use of instalment purchasing of durable producer goods. An additional justification is found, however, in the fact that they yield an income out of which the instalments may be met.

Value of Product in Relation to Bulk. This is the third physical characteristic of commodities. It is of importance in marketing chiefly because of its relation to the transportation function. It is perfectly proper to speak of a world market for diamonds, because it costs so little, in relation to their value, to send them anywhere in the world. There is also a world market for wheat, actual shipments being made from Australia to England. The freedom of movement, in this case, is not as great as with diamonds, but it does permit real competition in the Liverpool market between Canadian and Australian shippers. Common bricks, on the other hand, are not often shipped long distances because the transportation charges are too high in relation to their value. The geographical extent of the market for any good depends, therefore, in a large measure upon the relation between value and bulk.

Shape, Size and Nature of the Commodity for Handling and Marketing. Liquids and solids obviously require different packaging; some goods, such as large machines, are in units which require special handling; bananas are wrapped by nature in convenient form for retailing, while sugar must be packaged, and so on. Some commodities, such as sugar or flour, are handled in bulk or in large packages for the industrial trade, while they are usually handled in small packages for the retail trade. These characteristics influence the structure of the market and the methods of performing the physical functions of marketing, such as storage, grading, and transportation.

The extent to which a commodity may be standardized is also important in determining trade channels and methods of sale. For example, only goods which are standardized may be sold on organized exchanges. (See Chapter 13.) Further, as already pointed out, sale by description or sample presupposes accurate grading according to well-known standards.

The Use Made of the Commodity.—The use to which a commodity is to be put has an influence on the functions of exchange. *Industrial goods*—goods to be used in further production—such as factory equipment, are purchased by a relatively small number of buyers as compared with *consumer goods.* There are only one hundred twenty-five thousand industrial firms of all sorts in the United States, while there are nearly one hundred twenty-five million ultimate consumers. Locomotives may be sold to one hundred railroads, trolley cars to one thousand electric railway companies, automobiles to thirty million families. Obviously, the problems of assembly and demand manipulation are different and must be differently met as between these two classes of commodities. The other marketing functions are influenced, but not to the same extent as the functions of exchange.

Consumer Goods. Consumer goods may be classified according to the buying habits of consumers. Three principal groups stand out; convenience goods, shopping goods, and specialty goods.[1] The decision to consider any specific commodity or brand within one of these groups determines at least in part the marketing methods to be followed. The number and type of retail outlets, and the methods of demand manipulation depend upon this decision.

Convenience goods are those for which convenience of purchase is the dominant patronage motive. Generally for such goods there is little choice in the mind of the consumer between brands—Blisterine may be substituted easily for Listerine. Frequently, there is little choice between commodities within the class—for example, cabbage may be substituted for cauliflower. Usually there is an immediate desire which does not brook postponement. Unit prices are generally low, while purchases are at frequent intervals, and in small quantities. Thus, the reasons for the dominance of the convenience motive are of two sorts, namely: (1) there is insufficient difference between offerings to justify the trouble of shopping, and (2) purchases are so frequent as to make shopping too burdensome.

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[1] M. T. Copeland, *Principles of Merchandising,* pp. 11–18.

Staple groceries are generally bought as convenience goods. The most convenient place in this case may be the corner grocery, or it may be any store, which carries acceptable merchandise, and which delivers satisfactorily and at a definite time any goods ordered by telephone, and renders monthly statement of accounts. Many of the common articles purchased in drug stores and hardware stores also fall in the same class. Inquiry among consumers has shown beyond likelihood of error that convenience is the most compelling motive in the selection of a store at which to purchase such goods.

Shopping goods are those for which the consumer usually desires to have a variety from which to choose at time of purchase, in order to compare quality, price, and style. This class includes novelties, seasonable commodities, and small wares. It also includes many higher-priced articles which are bought infrequently, sometimes only once in a lifetime, such as furniture, pianos, high-priced jewelry, and so on. There is some question as to whether automobiles, radios, and similar articles, are shopping or specialty goods. Probably most people make actual comparison between several makes or brands at the time of purchase. To the extent that this is true, the goods are shopping goods; if on the other hand, they are purchased by brand name as the result of consumer advertising or any other influence which has made comparison with other makes unnecessary, then they are specialty goods.

Department stores are the shopping institutions *par excellence,* because they afford the best opportunity for comparison and selection. The demand for shopping goods is not urgent; the purchase can usually be delayed until opportunity offers for visiting the shopping district. A store catering to the shopping trade must carry a wide variety of merchandise. Since the tastes of shoppers differ, it is also necessary to have a large clientele, in order to warrant the expense of carrying certain goods for which demand is only intermittent. It is, however, difference in taste which makes it possible to carry the variety of merchandise found in modern department stores; what one consumer rejects another is delighted with.

The privilege of shopping is expensive. It costs materially more in proportion to sales to operate a shopping institution than to operate a convenience store. This point will be developed in detail in Chapter 20.

Specialty goods are branded articles for which a demand has been aroused in the minds of consumers, inducing them to purchase where they can obtain that particular brand. The slogan, "I'd walk a mile for a Camel," if and when true, perfectly introduces a specialty good. Specialty goods are often sold by only one, or a few, stores in a community; they may, however, be handled by any type of retail outlet. Generally their unit cost is a considerable amount and they are purchased infrequently.

Overlapping of the classes. These three classes of goods overlap. For example, Hart, Shaffner and Marx suits are bought as specialty goods by one person and as shopping goods by another; or silk hosiery is bought as specialty goods by some, as shopping goods by others, and even as convenience goods on occasion. Although every manufacturer who emphasizes his brand in sales promotion is attempting to make a specialty-good offering, many admit partial failure by distributing through convenience goods channels, while continuing intensive brand advertising. Wrigley's chewing gum, Campbell's soup, Gillette razor blades and many other advertised commodities are essentially convenience goods, if judged by the number and type of retail outlets which sell them. For such goods, which are of low unit value, consumer preference is sufficiently developed, so they are called for by brand name, but not sufficiently, so that purchasers will go far out of their way or take extra pains in shopping rather than accept a substitute.

Influence on trade. Although the lines are not clear cut between these three classes of consumer goods, trading is, nevertheless, definitely influenced by consumer buying habits. The distance which farm families in the Middle West customarily go to purchase various commodities is significant of this influence. A recent survey conducted by the Meredith Publishing Co. showed that, on the average, farm families in Iowa and Wisconsin traveled the following distances to make their purchases.

SURVEY SHOWING DISTANCES TRAVELED FOR PURCHASES

Distance in Miles	Commodity Purchased	Specialty	Shopping	Convenience
12.9	Women's dress clothes....		x	
11.8	Men's dress clothes.......	x	x	
10.4	Automobiles.............	x		
10.3	Gifts...................		x	
9.1	Furniture................		x	
9.0	Jewelry.................		x	
8.4	Children's clothes........		x	
8.2	Radios..................	x	x	
7.5	Men's work clothes.......		x	x
6.8	Auto tires...............	x		x
6.5	Drugs...................			x
5.1	Gasoline and oil..........			x
4.9	Groceries................			x

The distance traveled for typical convenience goods is much less than for shopping and specialty goods. Manufacturers of dress clothes can reach farm families through stores in medium-sized towns, but manufacturers of groceries and drugs must reach them through the small village outlets. According to the same survey, 45% of the farmers' purchases of dress clothes are made in towns of over 5,000 population, only 8% being made in towns of 1,000 or less. With groceries, on the other hand, 60% of purchases are made in towns of 1,000 or less.

There are some other characteristics of buying habits which influence the methods of purchase and sale of consumer goods. Commodities differ as to the number of consumers to whom they are sold. For example, all men buy suits of clothes; only 30% of men buy evening clothes; only 5% buy frock coats. The decision as to the place where different types of men's clothes are to be offered for sale (assembly function) is very different in these cases.

Some goods are purchased frequently—newspapers, for instance—while with others, such as bluing, one purchase will last six months or a year. The ability of manufacturers to develop consumer insistence for one brand (demand manipulation) is affected by such variations in the frequency of purchase.

The question whether an article is a necessity or a luxury, the influence of fashion, the extent of the market area, the purchase price per unit of sale, the need for "service" after the good has been purchased, the regularity and control of supply, are other factors which affect the sales methods for consumer goods.

INDUSTRIAL GOODS. As already stated, industrial goods require a different sales organization and selling technique than consumer goods. Like consumer goods, industrial goods may be classified into divisions or types, each of which has definite and peculiar market problems. Copeland[2] suggests five groups, based upon the uses to which the goods are put, rather than upon the buying habits of the purchasers. These five classes are: (1) installations, (2) accessory equipment, (3) operating supplies, (4) fabricating materials and parts, and (5) primary materials.

Installations, such as dynamos, blast furnaces, or mill equipment, are purchased in accordance with definite specifications.

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[2] M. T. Copeland, *Principles of Merchandising,* p. 132.

In their sale, the rendering of engineering or technical advice is frequently a major part of the salesman's activity. Certainly a thorough knowledge of the commodity—its installation and operating costs, its durability and efficiency, its ability to enhance productive capacity and earnings—is essential in the sale of such goods. Moreover, each sale is an individual matter, dependent upon the peculiar circumstances, both physical and financial, under which the purchaser's plant is operating. In general, installations are non-interchangeable, that is, they cannot economically be moved from one plant to another. Frequently, moreover, they are so highly specialized that they can be used for only one purpose within the original plant.

The manufacturers of installation goods sometimes retain title to them, in which case the user pays a rent or royalty. This is the case, for example, with certain telephone equipment and shoe manufacturing machinery.

Installations are generally made at the time of expansion of business or the opening of new businesses. Inventions, and the wearing out of old machines, also call for new installations. The task of the salesmanager involves, therefore, a forecast of business expansion.

Accessory equipment includes belts, cash registers, factory trucks, hand tools, and other auxiliary appliances. Such equipment does not determine the product to be turned out, as do installations, but it merely aids in the effective operation of the business. Accessory equipment is generally purchased more frequently than installations, it is standardized and interchangeable between plants and users, and the number of potential customers may be relatively large in any given territory. All industrial concerns are prospects for many lines of accessory equipment and, therefore, distribution is accomplished through manufacturer's agents or industrial wholesalers, whose salesmen call directly on the trade.

Operating supplies include many widely different items, ranging from lubricating oils and fuel, on the one hand, to stationery and paper clips, on the other. Such supplies are generally purchased by the firm's purchasing agent, who seeks to standardize, as far as possible, the supplies for each department. One of the serious problems confronting any purchasing agent is found in the lack of uniformity or standardization which exists in the case of most operating supplies. The United States Chamber of Commerce has recently reported that "fully 25% of all effort in American factories is wasted because of needless variations in sizes, styles and models." Certainly the costs of distribution, as well as of production, would be lower if industrial supplies were simplified and standardized.

Fabricating materials and parts and *primary materials* are sold to industrial plants in proportion to the activity or expected rate of output. The principal difference between the two classes, and the reason for separating them in an introductory study of marketing, is found in the conditions under which they are produced. In the main, fabricating materials and parts, such as springs for automobiles or rubber heels for shoes, are made for a specific purpose; they are highly standardized and, therefore, may be purchased entirely on description or specification. Primary materials, such as wheat, cotton, or iron ore, on the other hand, are generally purchased by manufacturers on the basis of inspection or analysis. Consequently, more dependence is placed upon the reputation of the seller by the purchaser in the case of fabricating materials and parts than in the case of primary materials.

Characteristics of Production.—Several things connected with the production of a commodity influence its marketing. These may be outlined as follows:

1. The Scale of Production. When goods are produced by a large number of small operators, as in the case of many farm products, the selling organization must be different from the cases where production is controlled by large producers; assembly, especially, must be differently provided for.

Moreover, the seller's bargaining power—the ability to influence market price—is greater when production is closely controlled. One reason for the development of cooperative selling organizations among farmers is the desire to approximate the bargaining power enjoyed by the large producer.

2. METHOD OF PRODUCTION.

Some goods are produced largely by nature. Such goods are frequently localized in point of production. This applies especially to the minerals which can be extracted only where nature has placed them. Agricultural production is limited, also, both by soil and by climate, although the limitations of location generally are not as rigid as with minerals. This characteristic influences especially the function of transportation, for such goods must be moved from the point of production to that of consumption. If their value—i.e., their utility and scarcity—is high relative to the cost of transporting them, they may be moved long distances. This is the case with such things as diamonds and dates, for example.

Moreover, nature has decreed that many agricultural products shall be seasonally produced. This fact influences the performance of the functions of storage and of financing, for goods so produced must be carried over until consumers will pay for them. For many such products, very elaborate and extensive storage facilities have been provided, such as the great elevators for grain and the cold-storage plants for eggs, apples, and similar commodities.

Another group of goods is produced largely by hand labor. This method of production is seldom found in the United States at present. Generally, hand-made goods are produced on a small scale and have a high unit value or price. Frequently, also, they are made to order. These characteristics will control, in part, the sales channels through which such goods may pass.

A large group of goods is made mainly by machinery. Such goods may be made either on a small or a large scale. Within limits, which need not be discussed here, machine-made goods may be produced at lower costs as the scale of production is increased. So long as this is true, there is a special reason for active demand manipulation (selling effort). The other marketing functions are frequently made subservient to this one.

In some cases, several different commodities emerge from the same productive process. Cotton fibre and cotton seed are so related in production that changes in the yield of one generally result in similar percentage changes in the yield of the other. When more steers are slaughtered not only is the supply of fresh meat increased, but also the supply of hides. When a railroad undertakes to move more freight eastward from the Pacific Coast it necessarily makes available more westward-bound freight space. Each of these examples is an instance of products jointly produced and necessarily so. For such commodities, the questions of assembly and of demand manipulation are highly complicated. One cannot be sure what effect an effort to enlarge the sale of one of the joint products will have upon the demand for, or the gain resulting from, the other products in the group. It is entirely possible that the enlarged supply of the secondary product will so depress its price as to more than offset any gain in total sales of the primary product.

There are other cases in which several commodities may be produced, but not in so definite a proportion. Thus, the dairyman may, at the same time, market milk, butter, cheese, beef, and hides. He may vary the proportions in which these several items are produced, however, to suit his fancy or the conditions in the market. Similarly, the management of a department store may either increase or close out one department without any direct, proportional effect on other departments. In all such cases, it is essential that careful attention be paid to the effect which changes in one product will have upon the supply of, demand for, and gain resulting from, the other products in the group. These are not true cases of joint products, although some of the costs of production are joint, overhead costs.

Conclusion.—In this chapter, and the two preceding, we have considered two cross-sections of marketing problems. In the first place, the outline of the marketing functions emphasized the basic things which must be accomplished by market institutions in modern exchange economy. This led to a definition of a "market" as a three-way concept, geographic, structural, and price-making. In the second place, the discussion of commodities has shown the influence which certain characteristics have on the performance of the market functions. The importance of each function in the marketing process is affected by the character of the commodity under consideration. This leads to various market institutions, which can place different emphasis on the several functions. In the chapters which follow, we shall describe the market structure which has evolved to meet this complex situation.

CHAPTER 6

CENTRAL MARKET STRUCTURE

Differences Exist in Marketing Structure.—The separation of producer and consumer, which was described in Chapter 4, has led to the development of numerous marketing functionaries. In earlier days, each of these undertook to perform all or most of the necessary marketing functions. Gradually, however, specialization and division of labor brought a variety and multitude of intermediaries, often resulting in much duplication of functions and services.

While such duplication of effort may result in unnecessarily high costs of distributing commodities, it is not always true that the consumer's cost of goods would be lower if there were fewer middlemen operating in the chain back to the producer. Specialization and division of tasks generally means greater efficiency, and this greater efficiency may more than offset the apparent costs of duplication. Certainly the marketing functions outlined in Chapter 3 must be performed by some one and their performance must be paid for. Whether indirect or more direct methods of marketing are best is, therefore, largely a question of relative total costs of performing all the marketing functions; while middlemen may be eliminated, the functions must still be performed.

Market Structure Depends upon the Type of Commodity.—The market structure of greatest efficiency and lowest cost varies between commodities. This is not because the basic functions to be performed are different, but because the nature of each commodity, or the demand for it, requires a different combination of demand manipulation, assembly, transportation, storage, and the like. As a result market structures have evolved with distinctive characteristics for the various types of commodities. The commodity differences pointed out in the preceding chapter are reflected in the marketing organizations which have developed. The physical characteristics of the commodity, the use made of it, and its distinctive production problems have all helped to shape the channels through which it moves.

It is not the purpose of the present chapter to describe in detail the marketing channels which have developed for specific commodities; to do so would be almost interminable, as is evident from the diagrams in Appendix A. The purpose is, rather, to classify the kinds of differences which are discernible between various market structures. Descriptive illustrations are presented for sake of clarity and without claim to completeness. Wherever possible, reasons are given for the major differences which occur within each of the classifications. The discussion is confined almost entirely to the central markets.

Classification of Central Market Structures.—The following outline shows the various headings under which markets may be classified:

A. With reference to the structure of the market
  1. Organized and unorganized markets
  2. Ownership of the market place or organization
  3. Who may trade in the market
  4. Completeness of information furnished by the organization to the traders

B. With reference to the geography of the market
  1. Relationships between various markets for the commodity in question

C. With reference to price making in the market
  1. The degree of competition
  2. Opportunities for adjustment of supply and demand

In the pages which follow each of these classifications is discussed.

A. With Reference to the Structure of the Market.—

1. Differences as to Organization. Trading may take place haphazardly, or in an organized and supervised manner. It is commonly said that "two women and a goose make a market." Such a market is not highly organized. In fact, most trading at retail is unorganized, at least so far as the buyers are concerned. The same condition may exist in the central markets. Hence, one may first differentiate between markets according as they are organized or unorganized.

(a) *Organized markets* are those where trading is regulated, either by the traders themselves or by some governmental agency, and where each trade is governed by certain written or implied rules. Such markets again fall into two classes:

(1) Organized markets *with* future trading and speculation. An example of this type is a grain exchange, such as the Minneapolis Chamber of Commerce. It has been said that the organized grain exchanges represent the highest degree of perfection which has yet been attained in any marketing organization. Of the consumer's dollar spent for bread, 3½ cents covers the entire cost of grain elevator and miller services, including selling expenses, storage charges, and the manufacture of wheat into flour.[1]

Wheat, one of the principal grains, is a commodity well adapted to efficient marketing because of its market characteristics. Among these characteristics the following are important:

World production insures supplies coming to the market at all times.

It is relatively non-perishable so that it may be held over for more than a season.

It is valuable enough in proportion to transportation charges to permit shipment anywhere.

It may be graded according to general standards.

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[1] Joint Commission of Agricultural Inquiry.

These commodity characteristics are probably essential to successful sale through an exchange which permits hedging. They greatly facilitate both the transfer of risk to specialists and the orderly marketing which helps to develop a stable price range. Moreover, they make it possible for the market organizations to make prompt adjustments in supplies to accommodate demand.

(2) Organized markets *without* future trading and speculation. Livestock markets are the best examples of this type. These markets are regulated by the federal government under the Packers and Stockyards Act of 1922.

Two features of livestock markets are of sufficient importance to warrant a brief description at this point. First, the central livestock markets of the United States, some 70 in number, comprise a system which has no counterpart in any other livestock producing country. As an outgrowth of this system there has developed a concentration of control of the stockyards, terminal facilities, and other equipment in the hands of the small group of packers who purchase the bulk of the meat animals sold at these markets.

"The functions of the central livestock markets can be summed up as follows:

> The livestock centers of the Mississippi and Ohio valleys serve as great cash markets, where cattle, hogs, sheep, horses, and other meat and draft animals can be sold by stock growers, breeders, and local dealers.
>
> They provide facilities for the handling, care, feeding, weighing, buying and selling of livestock, and the financing of sales.
>
> Through their exchanges they enforce rules governing the purchase and sale of livestock.
>
> They facilitate the collection of information as to the supply, demand, and other considerations influencing the trade.
>
> While livestock prices are not general, as are those of grain and cotton, the central markets do much to facilitate the quotation and publication of prices.

> They serve as central points from which livestock may conveniently be shipped to stockmen, feeders, and eastern buyers, and exported to foreign markets.
>
> Most of the central markets are great packing and slaughtering centers; indeed, they are the final markets for about 70% of their receipts of cattle, hogs, and sheep.
>
> Their concentration of large numbers of animals at relatively few places and their close connection with packing and slaughtering plants greatly facilitate the federal and state inspection of livestock and meats."[2]

A second important feature of the livestock marketing structure is found in the livestock exchanges located at the different stockyards. These exchanges have been of great significance in standardizing and stabilizing the methods of marketing livestock. These livestock exchanges, of which there are about 30 in the United States, are voluntary associations of livestock producers, shippers, packers, commission men, and bankers. They are organized, not for profit, but to secure in the mutual interest of consumers, producers, domestic distributors, and exporters of livestock and meat products, uniformity of business usages and customs, adequate inspection of animals and meats, needed legislation for the protection and promotion of livestock interests, and all other legitimate advantages to be secured through the power of organization.

Thus, it is seen that in the central market the purchase and sale of livestock is carried on under a high degree of organization, even though future trading is not provided for.

(b) *Unorganized markets* are those where trading is free to all—although it may take place in a central market place—and where the individual trade is not closely governed by regulations. An example of such a market is a fruit and vegetable market, such as is found in most cities. While the majority of the trading in fruits and vegetables generally is confined to a certain area in the city, much is also carried on elsewhere, and even within the main market place few, if any, trading rules prevail.

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[2] R. A. Clemen, *American Livestock and Meat Industries,* p. 538.

Some parts, even, of the fruit and vegetable markets are at least partially organized, i.e., trading is governed by rules and regulations. In the Twin Cities, for example, there are fruit auctions where carlot shipments from the South and West are sold to the trade under very definite market practice. Produce exchanges have been established in many cities, the purpose of which is to improve conditions in the trade. They lobby for legislation to improve marketing conditions and they regulate certain business practices of members. Machinery is generally set up for the adjustment of disputes between members.

In spite of these examples of organization within the produce markets, the trade is far less stabilized by rules, either written or traditional, as to methods of doing business or as to the regularity with which individual buyers and sellers operate, than the livestock and grain markets.

Some of the best illustrations of unorganized markets are found, not in the central markets, but at country points. For example, in the marketing of cotton the small producer often has to sell to a local buyer who has advanced funds to him. Under these circumstances the price paid may be affected by the amount of the debt, the terms of the mortgage or lien, the desire of the merchant to retain the goodwill of the farmer, and other considerations which would not be present in an organized market.

2. Differences as to Ownership of the Market Place.

(a) *Ownership by a general group of the people who trade in the market.* Here again, the grain and cotton exchanges will serve as examples. These are established by people in the trade, growers, merchants, storage companies, millers, and so on. Such exchanges are generally incorporated, and the trading floor is owned by the corporation. One principal purpose is the assuring of a convenient place in which to trade, democratically governed by rules of the traders' own making. Ownership shares in such organizations are usually transferable and in some cases inactive owners are forced to withdraw, in order that ownership may be kept in the hands of *bona fide* traders.

(b) *Ownership by a small group influential in the trade.* An example of this type is the Minneapolis Auction Company for the selling of carlot shipments of fruits and vegetables. A few fruit wholesalers own and operate this market, charging a fee for each unit of goods sold. Tobacco and rug auctions are generally similar. Up to 1923, the stockyards were owned and operated by the packers. A few small yards are still so controlled, although the larger ones are widely owned by a miscellaneous group of stockholders, some of whom are outside of any trading group. In any case, the owners collect a fee per head of livestock entering the market. When ownership is in the hands of a small group, there is opportunity for control of the market to favor the influential operators; such favoritism is less likely to occur in the democratically owned and controlled exchanges.

(c) *Owned by private individuals and corporations not directly interested in the trade.* The large stockyards, under their present form of corporate ownership, are essentially of this class. The Minneapolis Produce Market is privately owned. In such cases, the market place is a commercial enterprise in itself, which must be so operated as to yield a profit for its owners; it ceases to be merely an adjunct to the interests of a special group of traders. The control of trading rules and so on may be retained by the owners, as in the case of the stockyards, or it may be passed to the traders' organization or to some governmental body. In any case, control is likely to be in the interest of all traders rather than any one group.

(d) *Ownership by a municipality.* Most cities of large size have one or more produce markets owned and controlled by the city. Such markets are established to give a convenient and efficiently operated place for the local growers to meet the trade. In as much as many local produce men are small operators, they are likely to be at a disadvantage in the general wholesale receiving market, as compared with the carlot receivers. The municipal market has proved a satisfactory offset to this disadvantage. Wholesalers, many retailers, and occasional consumers buy in such markets. The individual producer may rent a stall for the display of his produce for either a long or a short period of time. Thus, there is a flexibility about such a market which is desirable and which might not be possible if the traders themselves owned the market place.

3. Who May Trade in the Market.

(a) *Only members of the organization owning and operating the market.* Dealings on the exchanges are limited to members. It follows, therefore, that most of the influential traders own one or more "seats" or memberships in these organizations. Membership regulations differ for different exchanges; in all cases financial responsibility and high moral qualifications are required. Only British-born subjects may be members of the London Copper Exchange. In another sense, however, these exchanges are open to every one. A considerable part of the membership is composed of commission dealers or brokers, whose function it is to buy and sell for others. Any farmer, merchant, or miller may have trades placed for him on a grain exchange, for example, by such an agent. In such cases, detailed instructions may be given, and they will be carried out to the letter just as though the principal was operating himself. In case any dispute arises over such transactions, the board of appeals of the exchange is as open to non-members as to members. The rules under which trading is carried on are laid down, however, by the members alone.

(b) *Open to all producers.* Produce markets generally admit any legitimate producer, but often exclude wholesalers and other middlemen from selling in the market. For example, in the Minneapolis market, any producer of fruits or vegetables may rent a stall upon the payment of $30 per season, or $0.25 per day; no dealers are allowed to rent space in this market. Any one may enter the market, however, as a buyer.

(c) *Open to any buyer and seller.* Typical of this class are the auctions. Here any producer may appear in person with his produce, as in the case of the city markets, or he may consign his goods to a commission agent, or direct to the auction company. Occasionally, carlot receivers will buy goods outright and later resell them on the auction. Any buyer may go to the auction and bid for the goods. In the case of fruit auctions, wholesalers do nearly all of the buying, however, particularly early in the season when prices are still relatively high.

4. COMPLETENESS OF INFORMATION FURNISHED TO TRADERS. For cotton, grains, some metals, and many other products, all buyers and sellers of the commodity are in fairly constant intercourse with one another, through exchange of information. Wheat, for example, is usually concentrated for sale in a few, well-known places. For any particular market place there is a "natural" area from which to draw supplies; wheat from northern Minnesota flows primarily through the Duluth market, while that from the southern part of the state usually flows through the Twin Cities. Potatoes, on the other hand, are not sent regularly to a certain market from a particular market area; supplies for a given market may be drawn from any of several surplus areas. Hence, in the latter case, buyers and sellers are not in close intercourse with each other, established, repeat-order business is not developed, and the full effect of supply and demand conditions are not felt in every market, as is the case with wheat.

Nearly complete knowledge of supply and demand conditions is available to buyers and sellers in markets such as the grain and metal exchanges. In each market, bids and offers are made openly and published promptly, and each trader has access to all of the centrally collected information. Even in such cases, the individual traders have their private sources of information which sometimes give them knowledge of changes in supply or demand earlier than it is obtained through the exchange. This is a matter of real competitive advantage, but the individual gains over his competitors in this type of a market most frequently by making a wiser interpretation of the information which is available to all.

In some other markets, bids and offers are made secretly, so that prices paid for one lot of goods may not be known to other traders. Such, for example, is the practice in the central livestock markets where bids are made—privately—for each particular lot of livestock. This difference in practice arises in part out of the organization of the market and in part out of the nature of the commodity. Livestock is not purchased by grade, as are commodities sold on exchanges, but by inspection of the individual offering, because it is impossible adequately to grade hogs and steers for purchase by description.

Closely related to this question of adequacy of information is the reporting of market news to traders located away from the market place. In the unorganized markets, price quotations and other market news frequently are not sent out by any agency, although it may be collected and reported by some newspaper representative. In the organized markets, on the other hand, reports as to the state of trade are sent out, in some cases daily and in other cases more frequently. The agencies sending out these reports differ, however. In some cases, as for example the central livestock markets, the government maintains market reporters to gather statistics and to send out daily analyses of the conditions. In other markets, as in the central grain markets, newspapers maintain a reporting staff in constant touch with buyers and sellers of grain; every sale may thus be reported on the market page of the city papers. In still other cases, reporting of prices may be carried on by a dealer, as in the New York butter market, where a representative of Urner-Barry Co., a commission firm, gathers and sends out price and market data.[3]

B. With Reference to the Geography of the Market.—

1. RELATIONSHIP BETWEEN VARIOUS MARKET PLACES FOR A SINGLE COMMODITY. A high degree of interrelationship and interdependence between the various central markets is found, for example, in the grain trade. Central markets like Minneapolis, Chicago, and Liverpool are closely tied together through price. The prices paid on any one day at each of these markets are ordinarily the result of all the known facts concerning supply and demand, brought to focus through complete market reports and the mechanism of "future trading." Prices will, therefore, normally differ only by the cost of shipment between markets and such artificial trade barriers as may exist. Any divergence from such normal spread between the prices in different market places is corrected by sending supplies from the low-price to the high-price market. Thus, the possibility of reshipment and the mechanism of future trading keeps the grain markets in line. To some extent the same thing is true for livestock and other commodities not highly perishable. In the livestock market, however, the same buyers are operating in practically all of the markets and can, therefore, discourage reshipping by adjusting their bids in the several markets. The metal markets of the world are bound together in much the same manner, and to about the same extent, as the grain markets.

The relationship between the markets for perishable commodities, such as some fruits, vegetables, and milk, is not nearly so close. In such cases, only *local* supply and demand forces are focussed to bring about the market price for the day. Occasional gluts and scarcities, with correspondingly low or high prices, may, therefore, be expected unless the people who perform the assembly and demand manipulation functions can forecast closely the daily conditions. Between such markets there is, then, no definite price relationship.

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[3] Some market data are also reported by governmental agencies.

For somewhat less perishable goods, such as citrous fruits, markets may be kept somewhat in line by careful planning of the shipments going to each market and the occasional use of the "diversion-in-transit" privilege granted by railroads. With this privilege, carlots of produce may pass right through the city for which they were originally intended if, on arrival, it is found that that market is better supplied than some other city further along the line; for this extra movement no additional charge is made. Cooperative shippers, especially, have taken advantage of this privilege in their efforts to keep prices for semi-perishable commodities in line between different market places.

There are other commodities, low in price and bulky, for which there is little price relationship between market places. Straw and common brick may serve as illustrations. In these cases, the limitation to competition between areas is due to the nature of the commodity and especially to the high cost of transportation relative to its price. When transportation costs are high relative to value, goods will not be shipped between producing areas unless the commodity is essential and cannot be produced generally.

Thus, it appears that relationships between geographically different markets depend upon the organization of the market for reporting market information, and upon the nature of the commodity, both as to its perishability and as to its value in relation to transportation costs.

C. With Reference to Price Making in the Market.—

1. The Degree of Competition. Nearly perfect competition is found in the more highly organized markets, such as the cotton and grain markets. Every buyer and seller has about equal knowledge of market conditions and, since the operators are generally large and well-financed, each is free to buy or

sell as he chooses. Agreements which affect price are rarely, if ever, found among either buyers or sellers. In fact, if prices depart in either direction from what an individual trader thinks they should be, he may change from a buyer to a seller, or vice versa, at any moment of the day.[4]

Monopoly or near monopoly characterizes other markets. In the marketing of steel, for example, there is little buying by middlemen for resale. Producers sell and users buy, and there is no reversing of the process as there is among the middlemen in the grain business. Moreover, it takes a great deal of capital and a considerable amount of time to get into the steel producing business, so that at any one time the sellers are a limited and fixed group. It is also true that steel producers may control their output much more closely than is possible in the case of many agricultural products, where the number of producers are legion and the yields are largely dependent upon conditions over which the individual has no control. Consequently, the *potential* competition by other producers of the same product is less with steel than with the other commodities. This may permit the price at any one time to be higher than in a freely competitive situation, but the possibility of substitution of other goods, the likelihood of new competition, and the danger of governmental interference prevent any long continuance of monopoly price even in such industries.

Many markets are subject to manipulation by either buyers or sellers. In some there may be only a few buyers against a multitude of sellers, in which case the buyers may agree as to trade policies and price. In other cases, the sellers may have the opportunity for close agreement. Such situations do not appear to be frequent, of long duration, or of great practical importance in present-day market transactions. In the livestock industry, the condition of a small number of large buyers has given rise to rumors of monopoly. Investigation by the

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[4] Some price manipulation by the most influential traders may, however, still be possible for short periods.

Department of Agriculture has indicated, however, that competition actually exists between these buyers. Similarly, there are only a few large buyers of cigarette tobacco, but in this case, again, there seems to be competition rather than any tendency to force the price down through agreements between buyers. There is possibly more tendency for agreement among producers of basic materials than among buyers, but there are evidences of keen rivalry among producers even in such industries as steel, gasoline, and copper.

In many cases, individual buyers or sellers have combined into a few large, cooperating groups, to meet similar combinations already existing on the other side of the market. Such movements are most clearly illustrated by the cooperative societies, both agricultural and consumer, which are discussed in Chapters 20 and 21.

It sometimes happens that one market place dominates the rest in the sense that the market forces which are significant in price making center at that point. Liverpool for wheat, Manchester for cotton, New York or London for copper and for rubber, have long been considered in this light. Prices elsewhere are adjusted to those in the dominant market by the differences in transportation and other trading costs.

2. The Readjustments Which May Be Made in Supply Following Price Changes. Immediate adjustment of supply following changes in price may be made in some markets, particularly those for many manufactured goods. For other products, especially farm products, adjustment cannot be made rapidly; the season's supply is already in existence and cannot be economically carried over to another season. Hence, sellers have little control over it. For perishable products, for example, sales must be made immediately, since the product cannot be carried for any material period of time. An increase in supply of products like fruit, milk, beef, and rubber can

come but slowly because of the time required to bring increased production to maturity.

Importance of the Differences Just Set Forth.—A study of the differences between central market organizations is of importance for several reasons. First of all, it points out some of the causes of variation in efficiency in the handling of different goods. This difference in efficiency, then, becomes a partial explanation of the diversity of costs of marketing various commodities. Secondly, it is conducive to a better understanding of present marketing facilities. And finally, it gives some basis for judging the proposed changes in the handling of certain commodities. Such considerations as the relative merits of present livestock marketing methods as compared with direct packer buying, the possible disadvantages of grain exchanges to grain growers, the adequacy of cooperative marketing to improve agricultural conditions, and other problems, can be intelligently approached only in the light of the existing central market structure, its history and reasons for being.

The preceding analysis of market structures, together with the standards previously set up for judging "a perfect market," should give the student a basis for judging the efficiency of present-day marketing and price making, as well as the probable effects of proposed changes.

CHAPTER 7

MARKET STRUCTURE FOR CONSUMER GOODS

Market Functionaries.—This chapter is devoted to a discussion of middlemen and agencies at present engaged in marketing. It should be pointed out, however, that there is a good deal of confusion of terminology as found in textbooks on marketing and in the trade. Furthermore, many middlemen perform functions not strictly within their scope of operation, so that a complete and accurate classification is hardly possible. In the following paragraphs, the principal functionaries are listed, and their operations described.

Brokers.—A broker is a market functionary who negotiates purchases or sales of commodities for others. The outstanding characteristic of a broker is that he merely *negotiates* the transactions by bringing buyers and sellers together. The pure broker performs only the demand manipulation and sometimes the assembly function. He assumes no responsibility, dealing always in the name of his principal. As soon as a trade is consummated, he is entitled to his commission, regardless of whether the goods are delivered or not. The pure broker usually does not represent any particular dealer or manufacturer, but is free to negotiate with any one and anywhere. No financing or storing is undertaken. He is usually paid a flat rate per unit of goods sold.

Brokers are particularly useful in trades where many small manufacturers produce only limited lines. The hardware broker, for example, performs a very useful service for wholesalers, seeking out all the sources of supply. For the small manufacturers of specialized hardware, who cannot have their own sales organization, he supervises sales and keeps the producer in touch with market conditions.

Like most other middlemen, the brokers often take over marketing functions outside of their real scope of activity. In some cases, the broker may become the sales agent for a manufacturer, or he may do a small jobbing business in addition to performing his brokerage functions.

TYPES OF BROKERS. Since the brokers' practices vary somewhat, a classification is difficult to make. Theoretically, at least, if a middleman performs other than the assembly and demand manipulative functions, he is not a broker. Most writers, however, classify brokers in accordance with the nature of the activity undertaken, recognizing that too fine a distinction between brokers and some other middleman would lead only to confusion.

A first class of brokers are the so-called *buying brokers.* They are engaged by the buyers, and hence stress the assembly function, seeking out all the possible sources of supply. Examples of buying brokers are found in the imported grocery, coffee, and rubber trades. A special case of buying brokers is the *purchasing agent,* operating primarily in the hardware, dry goods, and women's ready-to-wear trade. The manufacturers of these goods are often small and scattered, and the dealers, therefore, employ a purchasing agent to keep them informed about sources of supply and prices. Often these agents do no actual buying for a certain jobber, but merely keep him posted on prices and market conditions, so that the jobber himself may do more intelligent buying.

A second class of brokers are the *selling brokers.* They act primarily for the sellers and hence emphasize the demand manipulation function. In the marketing of canned goods, selling brokers play a prominent part. In marketing barrelled apples, large growers, cooperative organizations, and other local dealers often employ selling brokers. These brokers solicit bids from various buyers and forward the best bid to the shipper.

A third type of broker is the *merchandising broker.* "A large number of the ordinary brokerage businesses in the United States have always carried on a small amount of merchandising. Every broker finds it convenient, at times, to buy in order to supply small wholesale grocers, who are unable to buy the usual carload lots, or whose credit might be considered insufficient."[1]

A fourth type of broker is the so-called *specialized broker.* Under this heading may be grouped real estate brokers, "pit" brokers operating in the futures markets, insurance brokers, and stock brokers.

The Minneapolis classified directory for 1929 lists the following number of brokerage firms:

Food and grocery	26
Merchandise	18
Investment	10
General brokerage	6
Business brokers	5
Coffee	4

There are a total of 30 grocery and food products brokers listed, while there are only 14 grocery wholesalers in the same directory. These brokers make contacts with wholesalers or very large retailers.

Agents.—These middlemen are variously called sales agents, manufacturer's agents, selling houses or resident buyers. The services performed differ according to the trade. Agents differ from brokers in that they usually have more authority in determining methods of doing business. The agents ordinarily work under a definite contract, specifying the portion of the seller's output to be handled, the territory to be covered, and the price and terms at which the goods are to be sold. Manufacturer's agents often provide storage facilities, and may even help to finance their principal. Sometimes, as often happens in the furniture trade, the agent may propose changes in styles and designs. Mill agents often take the entire output of a textile mill, thus freeing the manufacturer from risk of loss due to price changes. There seems to be, therefore, a great deal of variation in the services and functions performed by sales agents, ranging from the ordinary agent who merely takes orders and who has no responsibility, to the mill agents who are really more like wholesalers.

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[1] Federal Trade Commission, "Report on Canned Foods: General Report on Canned Fruits and Vegetables," 1918, pp. 16–20.

Resident buyers in the dry goods trade are somewhat similar to purchasing agents. A resident buyer usually represents a number of dealers operating in the same line of business. Buying orders from these dealers can often be combined by the resident buyer, thus securing quantity discounts and perhaps better prices. The fee charged by the resident buyer may be paid by the purchaser or by the seller or by both.

Textile Factors.—The only marketing function performed by the textile factors is that of financing. They are specialized banking houses which advance a certain percentage of the value of the goods manufactured to the textile mills. They maintain credit and collection departments, taking over the accounts receivable for the mills, and collecting the accounts when due. This service is valuable to the textile mills since it enables them to concentrate on manufacturing and to avoid the trouble of collecting many scattered accounts. Further, banks often hesitate to tie up funds in accounts receivable or in goods with a fluctuating market value, without the introduction of some responsible financial organization.

Commission Merchants.—Commission merchants differ from brokers in that they have authority to sell the goods without first consulting their principal. These middlemen, sometimes called commission houses, commission men, produce merchants, etc., act as agents for the shipper, receiving the goods on consignment, and selling them in their own name. The commission merchant takes charge of the goods, may condition and grade them, and sells them when and where the best price is obtainable. He collects the proceeds, deducts his commission and other expenses incurred, and remits the balance to the shipper. He renders a complete statement of the transaction, an "account sales," to his principal.

COMMISSION MERCHANTS IN THE GRAIN TRADE. Commission merchants are very important in the handling of grain in the primary—central—markets, particularly in cash markets where sample selling predominates.

The principal function performed by the grain commission merchant is that of selling. He performs many incidental services for the shipper—usually a country elevator—chiefly in order to get business or to meet competition. He may advance funds to the shipper in part or in whole, particularly to shippers in sections where local banking is not well developed. He may aid the country elevators in the management of their business, by procuring managers, installing accounting systems, and supervising the records. He collects and disseminates market information, keeping his principals in touch with market conditions. Finally, he may perform the necessary hedging operations for the shipper. Commissions are 1% of gross proceeds in Minneapolis, with a maximum of 1 cent to 3½ cents per bushel, and a minimum of from ½ cent to 2 cents per bushel, depending upon the type of grain. Total charges for selling on consignment are thus very low.

COMMISSION MERCHANTS IN LIVESTOCK MARKETING. Sale by consignment is the principal method of marketing livestock. This is due primarily to the lack of accurate standards and grades. Quotations are, therefore, not an adequate guide for shippers, nor do buyers want to risk buying outright when quality is not defined. The method of operation is similar to that of the commission merchant in the grain trade.

COTTON FACTORS. These middlemen must be distinguished from the textile factors. Cotton factors are commission merchants, while, as already pointed out, the textile factors are essentially financial institutions. Before the coming of railroads and of cotton warehouses and compresses, cotton could not be stored locally. It was, therefore, consigned to a middleman known as a "factor," usually located in some central market or near transportation facilities.

PRESENT STATUS OF COMMISSION FIRMS. As already pointed out, marketing methods are constantly changing, and ample evidence of that is found in the commission business. The cotton factor has practically lost out for several reasons. Interior banks, compresses, and warehouses came with the development of railroads, enabling local financing and storing of the crop. Buyers then began to visit the interior markets, shipping the cotton direct to mills or to Europe. Further, cooperative marketing associations have made serious inroads on the consignment business. Practically all the factorage business now comes from interior merchants.

Commission dealing has also materially declined in the marketing of other farm products. One reason is the fact that country shippers are generally suspicious of the consignment method; dishonest commission men can take advantage of the shipper, particularly if competition is none too keen. Cooperative marketing has also brought a decline in consignment selling, particularly in the livestock industry.

Auction Houses.—Fruits, wool, tobacco, furs, and carpets are the chief commodities sold at auctions. Tobacco has long been marketed through auction companies. Selling wool at auction dates back to 1835. Fruit auctions were first used in 1847. Fruits are now being sold in increasing quantities through auction companies in all the important population centers in the United States.

The auction house is somewhat similar to the organized exchange. It is an independent organization, launched by dealers, for the purpose of providing a common meeting place for traders, and where trading may be regulated. The goods are consigned either by producers, or by middlemen in the central market, to the auction company, which receives, stores, and performs necessary grading operations. The receipts are catalogued—describing the products and their origin—and laid out conveniently for inspection by prospective buyers. Selling begins at a specified hour, bids are received in the usual manner, and the highest bidder gets the lines specified. It is but a matter of minutes to sell a carload of fruit consisting of upwards of one thousand packages. Anyone is free to attend the auction and make purchases. Practically, only dealers, mostly fruit wholesalers or manufacturers' representatives in the tobacco and wool trade, do the buying.

The auction company collects the proceeds of the sales, deducts its commission and other expenses, and remits the proceeds to the shipper. It collects market information and usually sends out market letters to shippers. Local dealers are kept informed about receipts and movements of products. In the fruit trade, if the market is poor on the day of arrival of a shipment, the auction company may advise the shipper to hold the goods over, or to reconsign them to another market. Thus prices, which for perishable products are likely to fluctuate widely, are often made more stable. Goods are sold "as is," all risk as to quality being borne by the purchaser.

Practices in the wool and tobacco auctions differ from the above described fruit auction only in minor details.

Auction selling appears to be on the increase so far as fruits are concerned; for other products rather the reverse is true. Cooperative marketing, when used, means less auction selling.

Auction selling presupposes standardized, well-packed goods, arriving in sufficient quantities to insure constant supply in season and low handling costs. It provides facilities for competitive buying of products and more price uniformity.

Wholesalers—Jobbers.[2]—Wholesalers have occupied a very prominent position in the distribution of most products. Manufacturers usually had no selling organization, but relied upon wholesalers to distribute their products. Similarly, retailers could not themselves seek out all the possible sources of supply and keep in touch with all manufacturers. Hence, the assembly function was left to a wholesaler, a person who bought a great variety of goods in large lots, and distributed these goods in smaller quantities to retailers. He could keep in close touch with retailers, anticipate their needs, and aid them in financing their purchases. Thus, the wholesaler performs the assembly, selling, storage, grading, financing, risk taking, and transportation functions.

When most products were sold in bulk, the wholesaler's services were essential for efficient distribution of goods. With the coming of specialty goods, advertising, and large-scale retailing, however, the importance of the wholesaler as a factor in distribution has declined somewhat. A manufacturer of a specialty, nationally advertised, cannot get the best possible results by selling through wholesalers who are simultaneously handling many competing varieties of the same products. Retailers who have tremendous buying power, such as chain stores, do not need the services of the wholesaler; they are large enough to have their own buying organization, and can buy in sufficiently large quantities to relieve the manufacturer of his selling problems, often taking his entire output.

It appears, therefore, that the wholesaler as a middleman has declined in importance. Ample evidence of that fact is found in any distributing center.

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[2] These terms are practically synonymous for manufactured products. Formerly, a jobber was a small-scale wholesaler. At present, the terms are used interchangeably, although a "jobber" exists—a person who handles job-lots, mill-ends, etc. In farm products marketing, a distinction is made in the trade: jobbers deal primarily with the retail trade, while wholesalers deal mostly with jobbers and other middlemen. Wholesalers generally buy in carload lots and sell to others in smaller lots.

TYPES OF WHOLESALERS.[3] Wholesalers may be classified according to the territory covered, or according to their method of doing business.

On the basis of the first classification, three types are evident:

1. *Local wholesalers,* who operate primarily within a single trading center and its immediate vicinity. Having a small area to cover, the local wholesaler can give some personal attention to his customers, making frequent calls and rapid deliveries. He handles primarily foodstuffs, unbranded staples, and some nationally advertised goods. Local wholesalers have grown in importance, relative to the other two types, in most lines.

2. *Sectional wholesalers,* usually located in some important trading center; their operations often extend over several states.

3. *National wholesalers,* usually located in New York, Chicago or St. Louis, who cover the entire United States. These wholesalers handle more specialties and style goods than the smaller wholesalers. Sometimes they have sectional warehouses for the distribution of their bulky goods, as is done, for example, by Butler Brothers, Austin Nichols Co., and others.

National wholesalers, and a few sectional, have private brands in so far as possible, and often manufacture a part of their merchandise.

On the basis of the second classification, several types of wholesalers are found:

1. *General merchandising wholesalers,* who, like the old general store, handle many lines, such as hardware, groceries, dry goods, and machinery. This type of wholesaler is now practically extinct.

2. *General line wholesalers,* who handle a complete assort-

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[3] See T. N. Beckman, *Wholesaling.*

ment of one line, such as all goods belonging to the hardware line, all belonging to the grocery line, etc.

3. *Specialty wholesalers,* who handle only a small part of the products of a given line. Thus, one wholesaler may handle cutlery, another paints, another bolts, etc. In the grocery line are found coffee and tea wholesalers, flour wholesalers, etc. The chief advantage in handling only a limited variety of products is that arising out of specialization in buying and in service.

4. *Manufacturing wholesalers,* who either manufacture a part of their line themselves, or who arrange to have the goods produced under the wholesaler's own brand. "Almost 78% of the wholesale druggists of Cleveland, Ohio, and about 82% of the jewelry wholesalers in Pittsburgh, Pa., combine to a certain degree the functions of manufacturing and wholesaling."[4]

5. *Semi-jobbers,* who act as both retailers and wholesalers. A retailer may enlarge his scope of operations to include supplying smaller merchants with some goods. Or, a wholesaler may enter the retail field by opening some retail stores. An example of the latter is the recent (1928) venture of Butler Brothers. Also, "semi-jobbers abound in large numbers in the electrical field and in the automobile accessory business."[5]

6. *Cooperative wholesalers* are found only to a limited extent, and principally in the grocery trade. A group of retailers, who have, perhaps, first been associated in a buying organization, may establish their own wholesale house, or buy one already operating. The wholesale house would then perform the same services as those performed by any independent wholesaler. An example in the grocery trade is the Allied Grocers of Minneapolis. The Hall Hardware Co., also of Minneapolis, is a cooperative wholesale hardware organization,

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[4] Maynard, *et al., Principles of Marketing,* p. 204.

[5] T. N. Beckman, *Wholesaling,* p. 42.

originally owned by a private concern, but at present owned and controlled by a group of retailers.

7. *Merchandising brokers,* who combine the brokerage and wholesale functions.[6]

8. *Drop shippers or "parlor" wholesalers,*[7] chain wholesalers,[8] branch house wholesalers, mail-order wholesalers,[9] and other wholesalers of lesser importance should also be mentioned.[10]

Retailers.—Retailing is, like wholesaling, carried on in many different types of establishments. Not only has retailing progressed from small to large-scale management—from unit store to chain store—but methods have changed to some extent during the past few decades. The old grocery store kept most of its products in bins, barrels and kegs, selling nearly all goods in bulk—a cat napping on the wrapping paper being the chief counter ornament. Today, most goods in the grocery store are in neat and more or less fancy packages on the shelves—with a bewildering number of brands and varieties—and only a small proportion of the goods is sold in bulk.

Specialization has also come in retailing, as it has in most other economic activity. One can seldom buy everything from matches to threshing machines in the same store any more. Competition has devised new and better means of attracting the consumer.

TYPES OF RETAIL ESTABLISHMENT.[11] The various types of retail establishments found at the present time illustrate the points made in the preceding paragraph.

1. *General stores,* handling nearly every kind of goods, have practically disappeared in some areas. They grew out of the trading post, and are found today mainly in sparsely

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[6] See p. 88.

[7] Wholesalers who do not maintain a warehouse, forwarding the orders directly to the manufacturer.

[8] Example, the Nash Wholesale Grocery chain in the Middle West.

[9] Send out catalogs in place of salesmen.

[10] See Beckman, *op. cit.*, pp. 49-57.

[11] Four separate classifications of retail outlets are given in Appendix B.

populated territories, where only one store can be supported. Stores handling more than one line, such as groceries and meats, are, of course, still prevalent. They are not, however, comparable to the old general store, which handled all lines, but are more akin to department stores.

2. *Unit stores or independent stores,* are the most common today, even in the larger trading centers. A survey in most cities would reveal, however, an appreciable decrease in the importance of the unit store as a factor in distribution, particularly for groceries and drugs, as compared with 10 years ago.

3. *Chain stores* have had a phenomenal growth during the past few years, particularly in certain lines. They are not new in American merchandising; the Great Atlantic and Pacific Tea Co. dates back to 1858, F. W. Woolworth to 1879, United Cigar Stores to 1900, and J. C. Penney Co. to 1902. It is during and since the World War, however, that chain stores have enjoyed their greatest advancement. Grocery and other chain stores are now found even in small cities of two thousand population and less. Some unit stores have had to give way because of their inability to withstand chain store competition of large buying power and lower selling expense. Co-operative buying has in many cases been resorted to by independent dealers to offset this difference in buying power and operating expense.

Chain stores may again be classified into the following groups:

(a) Retail store chains, organizations owning many stores and sometimes carrying on manufacturing as an incidental function. An example would be the Great Atlantic & Pacific Tea Company.

(b) Manufacturers' chain stores, operated by manufacturers primarily to furnish better distribution of their product. An example would be Browning, King & Company.

(c) Consumer's cooperative chains, similar to the first type mentioned but owned by consumers. These chains are found more commonly in Europe than in America.

(d) Buying associations of retail stores, which is essentially group buying by independently owned stores. An example would be the Independent Grocers' Alliance (I. G. A.) and the Rexall Drug Stores. These groups are often called *voluntary* chains.

4. *Department stores* are found in every trading center which is able to support a shopping institution. Most of their goods are purchased directly from manufacturers. The convenience of being able to buy all goods under one roof, and their "sales" campaigns and effective advertising, account largely for the success of department stores.

The latest innovation in department store merchandising is that of department chains, combining a large number of these institutions under one management. Whether this movement is due to the intense competition in merchandising or to economies of large-scale enterprise is problematical.

5. *Mail-order houses,* as Montgomery Ward and Sears Roebuck are old institutions, getting their start before the era of rapid and plentiful transportation facilities. The parcel post system and advertising enabled mail-order houses to bring city shopping services to the rural population.

An interesting phase of the mail-order house development of late has been the opening of retail branches in smaller cities. One reason for this development is perhaps the chain store competition; another the fact that the automobile has enabled the rural population to go to shopping centers more than formerly, thereby lessening the importance of catalog selling.

6. *Specialty shops,* in the strictest sense of the word, are further evidence of specialization in retailing. Women's millinery, men's hat stores, etc., may carry specialization to the extent of handling only one product.

It should, perhaps, be mentioned that this specialization has not invaded every retail field, as is evidenced by the assortment of goods handled by typical city drug stores.

7. *Manufacturers' retail branches* are established either because of a lack of other dependable outlets or because of a desire to get the full benefits of advertising. Many manufacturers establish chains to handle their whole output. Examples are W. L. Douglas Shoe Stores and Regal Shoe Co. Newark's advertise that they have 400 retail branches, selling six million pairs of shoes a year.[12]

These chains are successful because one manufacturer produces the full line which is sold through the store. No such retail organization would be practical for a manufacturer of a limited line of hardware.

8. *Direct selling concerns,* which establish no retail store in the ordinary sense, but distribute their products from house to house, are an important part of retailing. Well-known examples of this method of retailing include: (a) the Real Silk Hosiery Company, which is reported to have 10,000 agents, under the direction of 250 branch managers; (b) the Fuller Brush Company, with sales averaging about $15,000,000 per year; (c) the Jewel Tea Company and the J. R. Watkins Co., both of which retail from "stores on wheels," i.e., fully stocked delivery automobiles from which customers may select their purchases at the door. Other companies, such as the Aluminum Cooking Utensil Company, many manufacturers of vacuum cleaners, and others, sell part of their output through house-to-house canvassers and the balance through other retail outlets.

9. There are some *minor retail outlets* not included in the above descriptions. (a) Company stores or commissaries are attached to some large industrial plants, railroads, mining and lumbering companies. They are regular retail outlets, main-

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[12] Advertisement in Minneapolis *Tribune,* March 27, 1927.

tained to serve the employees of the company operating them. Frequently, in recent years, the employees have had a voice in the management of these stores, and have shared in the profits through patronage dividends similar to those paid by consumer cooperative stores. Recent estimates show that total sales through such outlets are about $1,250,000,000 per year. The U. S. Army Post Exchanges, of which there are about 150, may be considered special cases of commissary stores. (b) A small quantity of goods is still retailed in this country by auctions. This method is limited in general, however, to the disposal of second-hand goods or bankrupt stocks of dealers' merchandise. (c) Public markets are found in a great many cities. In these markets, perishable produce of all sorts is offered for sale. Much of the purchasing is done by retailers for resale, but some consumer sales are made. (d) Roadside markets are becoming more common as one result of the enormous growth of automobiling. In southern California many of the roadside marts are elaborate, all-year-'round affairs, carrying staple merchandise as well as seasonable produce. Generally, however, they confine their activities to the sale of locally grown, perishable produce in season. (e) There is a noticeable increase in the use of coin-operated, automatic vending machines or robots. In the main, however, these machines are placed for the convenience of patrons within existing retail establishments. They reduce the cost of selling certain thoroughly standardized articles, and a substantial increase in their use is predicted.

Present Status of Retail Trade.—A rough estimate of the amount of retail business done by each of the several classes of outlets is shown on page 101.[13]

A further picture of the present status of retail trade in the United States may be obtained from the table on page 102, showing the relative importance of different branches of re-

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[13] Paul H. Nystrom, *Economics of Retailing,* Vol. I, p. 376.

Estimates of Total Sales by Types of Retail Institutions, 1928

	Billion Dollars	Per Cent of Total Retail Trade
Chain stores, including all cases of two or more stores under one ownership and management	8.0	18.0
Department stores, including general merchandise stores	7.0	16.0
Mail-order houses, including about 1,200 concerns doing a mail-order catalog business	1.6	3.6
Company stores	1.2	3.0
House-to-house selling	1.0	2.3
Consumers' cooperative stores	.2	.4
Independent stores not included in any other classification	25.0	56.7
Total	44.0	100.0

tailing. This table also shows something of the change in importance of various branches during the past decade. Unfortunately the data are from different sources and are not absolutely comparable. They are reasonably accurate, however, and the main points of contrast are thought to be valid. The data for 1920 are taken from the classifications in the federal census for that year. The 1929 data are from the report of R. L. Polk and Co., publishers of directories, and they give evidence of being accurately compiled.

Certain contrasts in the data for the two years are of interest. Groceries were the largest single class in 1920, but were an even greater percentage of the total in 1929. Meat dealers, on the other hand, had declined markedly. Automobiles and accessory dealers showed the largest increase, and candy dealers more than doubled. While some of the differences are due to changes in classification, some of them are unquestionably due to changes in the buying habits of the consumers.

More specifically, it is possible to show for one city the number of wholesale and retail outlets which are supported by the surrounding population. While no two cities are exactly

IMPORTANCE OF DIFFERENT BRANCHES OF RETAIL TRADE

Classification	1920 Per Cent of Total Retail Outlets	1929 Per Cent of Total Retail Outlets
Total	100.0	100.0
Automobiles and accessories	2.2	14.1
Boots and shoes	1.7	1.9
Butchers and meat dealers	9.2	4.8
Buyers and shippers of livestock	2.3	
Candy and confectionery	3.0	7.4
Cigars and tobacco	1.4	1.8
Clothing and men's furnishings	3.5	3.0
Coal, wood and ice	2.6	
Department stores	0.9	0.4
Drugs and medicines	6.0	4.4
Dry goods and notions, including women's clothing	4.8	7.4
Five and ten cent stores	0.4	
Florists (dealers)	0.4	
Fruit	1.8	
Furniture	2.0	3.1
General stores	6.0	11.0
Groceries, including delicatessen	18.4	26.7
Hardware, stoves, and cutlery	3.1	6.4
Hucksters and peddlers	3.8	
Jewelry	1.6	2.1
Junk	1.7	
Lumber	2.1	0.4
Milk	1.0	
Opticians	1.0	
Produce and provisions	2.6	
Other specified retail dealers and shops	11.6	5.0
Not specified retail dealers	4.9	

alike in their ratios of different kinds of merchandising institutions, or in their ratios of outlets to people, yet the following picture of Minneapolis will serve as an indication of the general situation regarding a city market. The population of Minneapolis is approximately 460,000; that of the retail trade territory is close to 1,000,000; that of the wholesale trade territory approaches 6,500,000. The tables on page 103 give the wholesale and retail outlets in this city in 1929.

Merchandising institutions in small cities and towns are also important factors in the distribution problem. The principal agencies which supply people with merchandise and mer-

Wholesale Houses

Automobiles and trucks	26
Bakery goods	21
Beverages	12
Cigars, cigarettes, and tobaccos	20
Confectionery	36
Clothing—women's	9
Drugs and drug sundries	6
Dry goods and notions	14
Electrical appliances and fixtures	9
Florists	7
Footwear	16
Fuel and ice	51
Furnishings—men's	3
Furnishings—women's	20
Furniture	11
Furs and fur goods	16
General merchandise	9
Groceries and food products	14
Hardware	10
Jewelry	15
Lumber and building materials	151
Meats	26
Oils and gasoline	48
Paints, varnishes, and glass	44
Plumbing and heating	22
Radio	26

Retail Outlets

Aeroplanes and supplies	4
Automobiles and trucks	130
Auto accessories, supplies, garages	645
Bakery products	171
Books and stationery	38
Cigars, cigarettes, and tobacco	2,234
Confectionery, ice cream and soft drinks	294
Clothing—men's	92
Clothing—women's	93
Department stores	14
Drugs and drug sundries	239
Dry goods and notions	157
Electrical appliances and fixtures	116
Florists	62
Footwear	91
Fuel and ice	167
Furnishings—men's	72
Furnishings—women's	118
Furniture	106
Furs and fur goods	56
General merchandise	16
Groceries and food products	1,811
Hardware	129
Jewelry	135
Lumber and building materials	110
Meats	401
Musical instruments	42
Novelties and toys	66
Oils and gasoline	510
Paints, oils, varnish, and glass	31
Plumbing and heating	248
Radio	49
Sporting goods	20

chandising services in the country towns are the stores of various kinds, implement and automobile dealers, lumber yards, grain elevators and feed merchants, fuel dealers, and harness shops. Data on these outlets have been gathered from 603 towns in Minnesota having population of less than 11,500 each. "As would be expected, the data show that, in general, the larger the town the more the types of stores in it. The 339 towns having a population of less than 500 averaged less than one drug store per town, and more than half had none. Towns with a population of from 500 to 1,000 averaged a little more than one drug store per town. Only 5% of the

603 towns had no drug store. Similar data for furniture stores show that rarely do towns with a population of less than 1,000 people have such stores, and only 3 out of 4 towns in the 1,000 to 1,500 population class. General merchandise stores, however, are found in all towns, the average in towns of less than 500 population being 2.79. The minimum size of town for a jewelry store is approximately 1,000. Towns smaller than this average less than one. Ladies' ready-to-wear and dry goods stores do not average one store per town until the group ranging from 3,000 to 3,500 in population is reached. The minimum for men's clothing stores is 1,000 population. Shoe stores do not average one per town until the group having a population of 2,500 to 3,000 is reached. Variety stores average less than one per town in all groups under 3,000 in population. The data as to the minimum size of towns in Minnesota for various types of stores may be summarized as follows."[14]

	Population of Town
Drug stores	500
Furniture stores	1,000
General stores	*
Grocery stores	1,000
Hardware stores	*
Jewelry stores	1,000
Ladies' ready-to-wear and dry goods stores	3,000
Men's clothing stores	1,000
Shoe stores	2,500
Variety stores	3,000

* No lower limit.

With this preliminary and somewhat sketchy picture of the marketing structure in mind, we are ready to consider the price-making aspects of the market. In the next chapter, we shall consider the basic factors in demand, both economic and psychological. Then we shall take up the matter of price as it appears in the market place and some of the problems and policies which grow out of market price.

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[14] H. B. Price and C. R. Hoffer, University of Minnesota Agricultural Experiment Station Bulletin 249, pp. 11–12.

CHAPTER 8

MARKET DEMAND

The Nature of Demand.—By demand for any commodity, the economist means *the quantity of that commodity which buyers stand ready to take at some specific price.* That is, demand is a combination of desire and purchasing power on the part of buyers.

Two points require special emphasis in this definition. First, demand is the amount which buyers stand ready to take—offer to take. That is, demand must not be confused with (1) the amount men *want,* on the one hand, nor (2) the amount men *actually buy,* on the other. Demand must not be confused with the amount of a commodity which men *want.* "If wishes were horses, beggars might ride." Desire alone, not backed by purchasing power, is not economic demand. The penniless man looking in at the baker's window, however hungry he may be, adds nothing to the demand for bread. The desire of impoverished Europeans for American goods at the close of the World War did not constitute demand for those goods. On the other hand, purchasing power alone, not backed by desire, is not economic demand. There are occasional "buyers' strikes" during which demand may be less than purchasing power because of a lack of desire or willingness to buy.

Moreover, the concept of demand must not be limited to the amount *actually bought.* The amount of the commodity in question which was actually bought in a particular market at a specified price must have been the same as the amount which men stood ready to buy *at that price,* else it would not have been bought. This amount may be called the *realized demand.* But men stood just as ready to buy various other amounts at various other prices, and each of these combinations of quantity and price is as much a part of the demand as the special combination which was realized. Demand in this more general sense may be called *potential demand*. Realized demand is the potential demand at that price, but the fact that different prices will be paid for different amounts helps to determine the quantity of goods produced and offered for sale.

A second point in our definition which needs emphasis is the phrase "at some specific price." Every proper statement affirming the existence of a demand must explicitly or by implication represent this demand as conditioned on a certain price. Thus, it is proper to say, "The world demand for wheat at $1.20 per bushel is 1½ billion bushels." It is not proper to say "The demand for wheat is 1½ billion bushels," leaving out the phrase "at $1.20 per bushel," except on condition that both the person making the remark and the one to whom it is addressed already have one particular price in mind, as for example, the price at which sales are actually being made at the time the statement appears.

The Demand Schedule.—Demand as we have just seen, is always relative to a particular price, stated or implied, and the amount of demand, generally speaking, varies inversely, though not always proportionally, to price; the lower the price, the greater the demand, while the higher the price, the smaller the demand. This applies to the potential demand at any of a series of prices. It applies, also, to the realized demand at any one price; if the market price for the moment is high, the quantity purchased will be small, while if the price is low, the quantity taken will be correspondingly high.

In Figure 4, if the market price is set at P_1, or $0.25 per unit, Q_1, or 8 units, will be taken. Eight units, then, is the realized demand. If the market price is at P_2, or $0.50 per unit, the quantity taken will be only Q_2 or 4 units, which is the realized demand at the new price. *Any* point on the line *DD*, on the other hand, represents a potential demand at some price, which may be located on the *oy* axis. The quantity of such demand may be measured on the *ox* axis, by dropping a perpendicular from the point on *DD*.

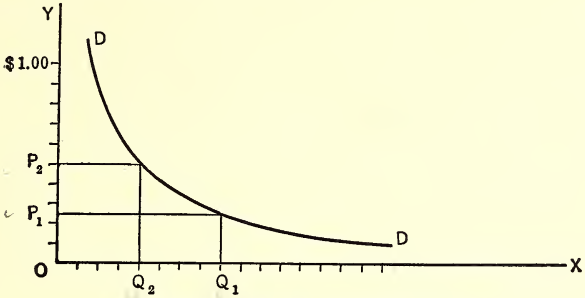

Figure 4. Diagram of Demand

It follows, then, that the facts of demand at any time require for their adequate statement a series of conditional propositions. Thus, the supposed case for wheat would be most adequately stated as follows:

The demand is 1,380 million bu. if, and only if, price is $1.25
“ “ “ 1,500 “ “ “ “ “ “ “ “ $1.20
“ “ “ 1,600 “ “ “ “ “ “ “ “ $1.15
“ “ “ 1,695 “ “ “ “ “ “ “ “ $1.10
“ “ “ 1,790 “ “ “ “ “ “ “ “ $1.05
“ “ “ 1,875 “ “ “ “ “ “ “ “ $1.00
“ “ “ 1,945 “ “ “ “ “ “ “ “ $ .95

Such a series of propositions we call a demand schedule. Each proposition may be restated to read as follows: “If the commercial wheat crop of the world is 1,500 million bushels, a price of $1.20 per bushel will just clear the market, while, if the crop is 1,875 million bushels the price must be as low as $1.00 if all the wheat is to be consumed.” The student must always remember that a series of such conditional propositions is essential for a complete statement of the demand which exists at any moment of time.

It follows from what has been said that an increase in sales following a lowering of price does not represent a change in demand; such a condition means merely that another part of the existing demand schedule has been realized. A *real* change in demand is realized in the market only (1) when more or less of a commodity is taken without any change in price, (2) when the same amount of a commodity is taken at a new price, or (3) when both price and quantity taken change, but in other than the anticipated ratio. This concept of demand and of changes in demand must be kept in mind if ambiguity is to be avoided.

The demand manipulation (selling) function in marketing is concerned with bringing about real changes in demand as just defined. Unless sales promotion efforts increase the quantity which will be taken at a price, they are unsuccessful attempts to change demand. Successful demand manipulation for one commodity frequently results not only in increasing the demand for that commodity, but also in reducing the demand for something else. In this sense, every commodity is in competition with all other commodities for a share in the purchasing power of consumers.

It has seemed necessary to define demand thus fully before discussing the things which influence it. The subject has by no means been exhausted; the student will meet with it again and again in later studies in economics as well as in business contacts.

Elasticity of Demand.—Commodities are constantly changing in price. The complete explanation of these changes is a matter for future study. It is only necessary to point out here that changes in price affect the quantity purchased—realized demand—in different degree with different commodities. The degree of responsiveness of purchases to price change is called "elasticity of demand." Numerous recent studies illustrate the differences in responsiveness. For example, it is reported that a 5% change in the price of sugar, wheat, or potatoes is accompanied by approximately a 2½% change in quantity taken—

that is, there is a less than proportional change in purchases. With corn, a 5% change in price is accompanied by a 5% change in quantity purchased—just proportional. With lamb, hogs and beef, a 5% change in price brings from 7% to 9% change in purchases—more than proportional.[1] No change in demand is indicated in any of these cases, when that term is used as we have defined it. The differences in the changes in quantity taken which accompany definite changes in price, in such cases, are merely illustrations of different elasticities, or different complete demand situations; the coincident change of price and quantity taken means that another part of the existing demand schedule has been realized.

Commodities like corn, for which the coincident changes in price and in quantity demanded are just proportional, are said to have *unit elasticity.* Commodities like sugar, wheat, and potatoes, with which the proportional change in quantity demanded is less than the change in price, are said to have *inelastic* demands; with them price concessions do not result in corresponding increases in sales. Commodities like livestock, with which the proportional change in quantity demanded is greater than the change in price, are said to have *elastic* demands; with them price reductions may be expected to result in relatively large increases in sales.

Studies of "elasticity" are of importance in marketing because they indicate the effect which changes in price will have on sales. If a sales manager has accurate information on the amount of business which will be secured or lost if price is moved up or down he will know better how to decide many baffling questions of price policy. This question deserves much more attention from advanced students of marketing, and from professional operators in the market, than it has so far received.

In general, it may be said that necessities, staple commodities, things which are in constant, customary use, have inelastic demand schedules. Many of the staple food products, medium-priced articles of clothing, items sold most commonly by hardware stores, all belong in this class. For such articles, price concessions may change patronage from one store to another, or from one week to an earlier one, but they are not likely to increase the total seasonal sales.

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[1] See W. C. Waite, *Economics of Consumption,* p. 100.

In contrast, new items frequently have very elastic demand schedules. When air-mail rates were reduced from 10 cents to 5 cents the volume of business much more than doubled in a very short time; in other words, the total revenue collected became greater in spite of the reduction in price. Similarly the purchases of style goods, novelties, high-priced items, such as automobiles and radios, are materially affected by price changes. The popular use of the automobile was dependent upon the production of a comparatively low-priced car, and the popular use of airplanes awaits similar production. Books are often brought out in popular editions at moderate prices, after their initial run, with resulting enormous stimulation of sales.

A clear distinction exists between the changes in realized demand which result merely from changes in price and those which result from changes in potential demand, or a shifting of the demand schedule. Elasticity refers only to the former and studies of elasticity are of value to the buyer or seller because they tell him what to expect immediately from changes in price or in quantity offered for sale. Demand manipulation, on the other hand, is concerned with a different problem, namely, a shifting of the entire demand schedule.

Income and Demand.—Income is undoubtedly the greatest single influence on demand, for, in general, income sets the limits for purchases and consumption. There are some very important monetary complications in the exchange of individual incomes for specific consumption goods, which we cannot develop at this point; discussion of them will come in the study of the financial organization of society and with the more

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complete study of economic principles. Suffice it to say here that total consumption, over any considerable period of time, is equal to total income.

The purchasing power of the various social groups, i.e., land owners, laborers, managers, and so on, varies from year to year. For instance, the spring wheat crop may be poor, in which case the income and resulting purchasing power of the wheat farmers is low. Or a prolonged strike of textile workers will lower the purchasing power of industrial New England.

Moreover, there is at all times a striking inequality between the incomes of individuals. The distribution of personal incomes in the United States for 1918, as measured in money, is given in the following table:

152 persons, or	0.004%, had incomes of	$1,000,000	or	over
7,285	0.02	100,000	to	$1,000,000
14,011	0.03	50,000	"	100,000
41,119	0.11	25,000	"	50,000
192,062	0.51	10,000	"	25,000
587,824	1.56	5,000	"	10,000
1,383,167	3.68	3,000	"	5,000
3,065,024	8.17	2,000	"	3,000
5,222,067	13.92	1,500	"	2,000
12,428,120	33.14	1,000	"	1,500
12,531,570	33.44	500	"	1,000
1,827,554	4.87	0	"	500
201,000	0.52	0	or	under[2]

Inequality of income has an effect not only upon total purchasing power, but also upon the percentage distribution of expenditures by individual families. For example, food constitutes over 40% of the total expenditures of families whose income is $1,500, while it is less than 20% for the families with incomes of $10,000, and less than 10% when income is $35,000 or over. Expenditures for rent and clothing, on the other hand, remain more nearly a constant percentage of income, which is the same as saying that these latter expenditures increase at approximately the same rate as does income.

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[2] Nat. Bur. of Econ. Res., Income in the United States, Vol. 1. There have been some minor changes in the distribution of personal incomes since 1918, but they are not important for our purposes. For instance, the percentage of money income of the United States, which was received by the wealthiest 10% of the population, was 33.1% in 1918 and 32.9% in 1926.

The following table gives the best available estimates of the average *dollar* expenditures for families in the United States with different incomes. Figures are given only for the major expenditures and do not include the entire income.

AVERAGE YEARLY EXPENDITURES PER FAMILY[3]

Income	Food	Clothing	Rent	Misc.
$1,200-$1,500	$ 515	$ 200	$ 180	$ 262
1,500- 1,800	572	257	207	335
1,800- 2,100	626	307	232	404
2,100- 2,500	711	384	284	500
2,500- 3,000	860	503	260	608
$ 5,000	1,360	725	900	1,175
10,000	1,920	1,190	1,830	2,810
25,000	3,000	2,175	4,800	8,700
50,000	3,050	3,200	10,000	20,500

These differences in purchases between income groups indicate something of the field for demand manipulation efforts with the various groups.

Recent studies of incomes and expenditures of Minnesota farm and city families develop some interesting differences between the expenditures of these two classes. These studies represent a cross-section of Minnesota population, including all income and occupational classes. As is to be expected, the consumption of all items increases in amount and value as incomes rise, for both groups. This is clearly indicated by the tables on page 113.[4]

In terms of proportions, expenditures for food, household, clothing, and health all decline in importance as incomes increase. Food and household expenses are markedly a greater

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[3] Bur. of Labor Statistics, Bul. No. 357, for incomes below $5,000; Nat. Bur. Econ. Res., *Income in the United States*, for incomes over $5,000.

[4] C. C. Zimmerman, University of Minnesota Agricultural Experiment Station, Bulletin 255, 1929.

FARM FAMILIES

AVERAGE AMOUNTS SPENT PER FAMILY FOR VARIOUS CLASSES OF *Living* EXPENDITURES, BY INCOME GROUPS

Income Groups	Average Total Living Expenditures	Average Amounts Used for				
		Household and Operation	Food	Clothing	Health	Miscellaneous
Less than $1,000	$ 624	$140	$211	$135	$ 78	$ 60
$1,000–$1,999	828	168	284	147	93	136
2,000– 2,999	1,028	213	309	234	86	186
3,000– 3,999	1,142	204	362	224	142	210
4,000– 4,999	1,240	355	380	235	54	216
5,000– 5,999	1,582	287	394	391	171	339
6,000 or more	1,869	498	474	371	160	366
Total average	$1,122	$246	$337	$229	$108	$202

CITY FAMILIES

AVERAGE PER FAMILY DISTRIBUTION OF *All* EXPENDITURES, BY INCOME GROUPS

Income Groups	Average per Family Expenditures for						
	Investments	Household Purposes	Food	Clothing	Automobile	Health	Miscellaneous5
Less than $1,000	$ 36	$ 239	$433	$119	$ 18	$ 55	$ 95
$1,000–$1,999	218	465	455	172	59	100	148
2,000– 2,999	556	609	595	281	165	114	224
3,000– 3,999	903	692	673	346	308	79	340
4,000– 4,999	1,218	880	662	414	388	182	605
5,000– 5,999	2,173	860	591	491	580	100	477
6,000 or more	7,283	1,625	902	721	891	230	1,183
Total average	$1,514	$ 724	$597	$327	$279	$122	$ 380

proportion of urban expenses in the low income groups, but the difference is not important at the higher levels. The care of health requires a greater proportion of expenditure on the farm than in the city. These points are verified in detail by the data of the following table:

FAMILY DISTRIBUTION OF EXPENDITURES, BY INCOME GROUPS

Average Percentage Expenditure For	Income Groups					
	Less than $1000		$3000-$3999		$6000 and Over	
	Farm	City	Farm	City	Farm	City
Investments	31.0%	3.6%	34.0%	27.0%	58.0%	56.7%
Household (including rent)	13.7	24.0	10.0	20.7	8.0	12.7
Food	20.6	43.5	17.0	20.2	7.6	7.1
Clothing	13.4	12.0	9.2	10.3	6.0	5.6
Automobile	8.0	1.8	12.0	9.2	12.0	7.0
Health	7.6	5.6	6.7	2.4	2.6	1.8
Miscellaneous	5.8	9.5	10.1	10.2	5.9	9.2

The most striking increases, both proportionally and in dollars expended, are found in investments. This is money which is not required for physiological living purposes. It is peculiarly subject, therefore, to expenditure in accordance with the demand manipulation efforts of various merchandising agencies. Especially in the lower income groups, farm families invest a larger percentage of their income than do city families.

The Manipulation of Demand.—The dollar which buys the absolute essentials—food, clothing, shelter—is in a sense a mortgaged dollar. It must be spent because possession of these things is absolutely necessary to existence.

But even these necessities may be supplied by different specific commodities; Grape-Nuts or Shredded Wheat will equally well satisfy the food requirements at the breakfast table, and at approximately the same cost. Direct selling persuasion, together with style, design, location, form and manner of delivery, credit and other store services, are among the influences which are sufficient to cause variations in the specific commodities which will be taken.

Clothing is commonly regarded as a need. Yet a considerable part of clothing sales result from merchandising efforts which develop wants and desires. Whenever these wants and desires become strong enough to change the direction of expenditure, there has been a manipulation of demand.

The larger the income, the more optional expenditures there are, for all of the inexpensive, and a growing number of expensive, methods of satisfying the basic requirements are then available.

Moreover, as income grows, more and more may be expended in satisfying the desire to play, or the various egotistical urges which are not essential to life itself. The consumer is free to spend his larger income for any will-o'-the-wisp which pleases his fancy.

Many magnets are set to attract these free dollars. One and a half billions are spent annually in the United States for advertising; this is nearly 2% of the entire national income. Personal selling takes at least five times as much expense. Window displays, demonstrations, "sales," and a host of artifices are included among the tools of demand manipulation, the purpose of all of which is to influence human behavior—to shift the entire demand schedule for specific commodities.

The Psychological Nature of Demand.—Demand for specific products is influenced not only by purchasing power but also by human reactions to many complex stimuli.

Demands arise out of human needs. The chief needs of men and women are based either on their native and instinctive tendencies or on their firmly established habits. It is unimportant in the performance of the demand manipulation function of marketing whether the tendencies are instincts in the strict biological sense, or whether they are acquired habits. The important thing is that "the purchaser is equipped with an array of fundamental cravings and reaction tendencies which are common to all members of the race, and which constitute the great driving forces of his life and which motivate his choices."[5]

In certain fields of activity, profit or gain becomes the motive controlling human activities. Throughout industry, goods are exchanged with a hope of profit in mind. Economy in purchase or in use, enhanced productivity of the plant, efficiency, dependability, durability, adequacy of maintenance service, these and similar *rational* motives determine the purchase of industrial goods. Advertisers recognize the strength of these motives in the sale of such goods. Substantially all of the advertising copy in industrial and trade journals is "rational" in tone, that is, it emphasizes the connection between the suggested purchase and the resultant profit or gain.

Buying motives, for consumers' goods, on the other hand, are more complex. Instead of being mainly rational, they are largely *emotional*. Advertisers also recognize this fact. For example, a study of advertisements in a series of general and women's magazines listed the motives most frequently appealed to as follows:

1. Pride of appearance (personal and property)
2. Pleasing or satisfying the appetite
3. Securing personal comfort
4. Emulation
5. Maintaining and preserving health[6]

The exact order of frequency of these appeals is not particularly important; the fact that nearly half of the appeals appearing in the magazines studied were listed under these five headings, and that only one quarter of the total were rational appeals, is significant. Evidently, for consumers' goods advertisers have greater confidence in appeals directed at the emotions than in those which are rational.

The appeals which influence consumer purchasing may be classified not only as rational or emotional, but also as *primary* or *selective*—or to use Kleppner's terms,[7] as *pioneer* or *competitive.* The primary or pioneer appeals are those by which the effort is made to expand the demand for some commodity in general, without reference to a particular make or brand. Many cooperative advertising campaigns illustrate this type of appeal. Slogans such as, "Say it with flowers," "Save the surface and you save all," "Eat more wheat," "An apple a day keeps the doctor away," are typical of this sort of appeal. Thirty years ago, music boxes were in the pioneer stage as far as acceptance by the public was concerned; twenty years ago phonographs were in that stage; today radios are just emerging from the same stage. In each case, primary appeals prevailed in selling. Later, after the basic idea or device became accepted, competitive or selective appeals were used almost exclusively. The object had become to establish in the consumer's mind points of superiority for one make or brand.

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[5] Tipper, Hotchkiss, Hollingworth and Parsons, *Principles of Advertising*, p. 70.

[6] Adapted from M. T. Copeland, *Principles of Merchandising*, p. 178.

These two classifications, rational or emotional appeals on the one hand, and primary or selective on the other, are overlapping rather than mutually exclusive. It will be interesting for the student to take any current publication and see which appeals are used by advertisers. Many contrasts will be found between different commodities and also between different publications as, for instance, a city daily and the *Saturday Evening Post.* A count of these differences may be made conveniently on a two-way diagram like the following:

Classification of Appeals

	Rational	Emotional
Primary (Pioneer)		
Selective (Competitive)		

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[7] O. B. Kleppner, *Advertising Procedure,* Ch. 1.

The Fundamental Drives.—There are certain "fundamental drives," or combinations of instincts and habits, around which either rational or emotional appeals may be built. The following list includes those which are most frequently appealed to in demand manipulation efforts:

Acquisitiveness
Anger
Appetite
Cleanliness
Comedy
Comfort
Competition
Constructiveness
Cunning
Curiosity
Devotion
Fear
Gratitude
Harmony
Healthfulness
Imitation
Leadership
Ornamentation
Play
Pride
Sex
Slyness
Sociability
Sympathy
Worship

Rational appeals will fall mainly under the first heading. That is to say, arguments regarding efficiency and economy have as their principal objective the acquisition of greater profits. Rational appeals may grow, however, out of conditions of competition, fear of losing part of one's market, the value of leadership, and so on.

Emotional appeals may be directed toward any of these fundamental drives, but with varying effectiveness in determining the conduct of people. It has been said that "the instinct of human tenderness is the hope of the world"; but the world has not yet reached the point where sympathy, sociability, gratitude, and harmony are strong buying motives. In fact, these *social* drives are generally the weakest of the emotional appeals in their influence on human action.

Certainly the *racial* drives are generally strong enough to overcome social constraints. For example, the impulses of parental and filial devotion often take precedence over social laws. Similarly, the tribal or national bonds are much stronger than international interests, although the "international mind" is gaining strength. Among the racial drives, of intermediate force, may be classed parental and filial devotion, the sex reactions, worship, community and national pride, and the like. These are certainly of greater commercial importance than are the social drives.

Nearly all people are essentially individualists, with their egotism highly developed. Consequently the *individual* drives furnish the strongest commercial appeals, that is, those which most clearly and directly influence human conduct. It is difficult in our present stage of knowledge to rank the individual drives in order of strength. It is safe to say, however, that for a large part of the population the negative drive of fear is the most impelling influence in their lives. Fear, however, is generally a fear of something definite and the influence of fear appears, therefore, as a danger of loss to some more positive emotion. Pride—of possession, appearance, or leadership—is among the strongest of the positive appeals. Healthfulness and comfort are likewise important. Acquisitiveness needs to be strongly emphasized. With some people—often with children especially—constructiveness or the urge of workmanship is an impelling motive. Certainly at times, parental and filial devotion, which were classed with the social drives, are as strong motivating forces as the individual drives, although their strength probably can be explained on egotistical grounds.

In spite of what has just been said about the ease and effectiveness with which the individual drives may be appealed to commercially, there is throughout society a disposition of kindliness toward one's fellowmen generally. "The happy behavior of others is pleasant, as flowers and sunshine and food are." Henry Ford is urging a shorter working day so that wage-earners may have more leisure for the consumption of the increasing products of industry; but the social tendency, on the other hand, leads to a desire on the part of parents to play or romp with the children or merely to watch their antics, rather than to consume more goods. In many cases, certainly, people must be taught, or urged, or cajoled into the consumption of goods even when they have both leisure and money. This is one task which manufacturers and merchants have accepted under the function of demand manipulation, in order that there may be mass consumption to support mass production, from which a considerable part of our material prosperity is said to have grown.

Men and Women as Consumers.—In nearly all retail trade, women are the principal buyers. It is estimated that women spend at retail in the United States about fifty-three billion dollars a year—approximately 60% of the total national income. Estimates of the proportional purchases by men and women are given in the following table:

RETAIL PURCHASES BY MEN AND WOMEN

	Men	Women
Drug Stores	22%	78%
Department stores	18	82
Grocery Stores	19	81
. . . . .	. .	
Automobiles	59	41
Electric supplies	20	80
Hardware	51	49
Jewelry	20	80
Leather goods	33	67
Men's neckwear	37	63
Men's socks	25	75
Pianos	22	78
Silks	2	98

One basic difference between men and women is that women live closer to their instincts and emotions. Men get satisfaction from the solving of abstract problems, while women get their greatest satisfaction from the objects and surroundings immediately around them. That is why Mrs. Consumer is the heart and center of the merchandising world. She is more deeply concerned in her surroundings than men generally realize. Women are emotional, therefore they are suggestible and the keynote of this suggestibility is the desire for change.

Men refuse to give up their old clothes or their old chair and the comfort which goes with them. For clothes and shoes men rank comfort of greatest importance in purchasing, while women rank style and appearance first. Women must have something new if they are to be happy. And in this prosperous country and age Mrs. Consumer may satisfy her desire for change. She refuses to "wear out" goods if there is something new and better and more beautiful offered, or if "Mrs. Jones" is wearing something new, whether it is beautiful or not.

Generally speaking, man is not a shopper. He is a one-shop, even a one-brand buyer. His hats, shoes, suits, shirts come from the same shop year after year. Women, on the other hand, are impelled by greater curiosity—they constantly try new brands, new commodities, new shops.

Women are spending more money in their shopping than ever before and for at least three reasons. In the first place, they have more leisure. Many devices are relieving them of household drudgeries. Houses are smaller and children are fewer. Social life is more active.

In the second place, a single outfit of clothing costs less, which paradoxically leads to the purchase of more clothes. It is probably easier to be tempted into buying ten dresses at $15 each, bought at irregular intervals, than it was into buying one dress at $60.

And thirdly, men are spending less on themselves, thus leaving more for the women to spend. The proportion of tailored to "ready-made" suits is much smaller than it was a generation ago, because factories have learned to copy the tailored clothes at mass-production costs. The savings have gone into women's expenditures.

Fashion and Its Influence on Demand.—Among the many manifestations of the interplay of the fundamental tendencies just discussed, none is more important nor conspicuous than the phenomena of style and fashion. Style may be defined as a characteristic or distinctive mode or method of expression. There are styles of dress, of furniture, of architecture, of writing, of music; in fact, every human activity is subject to style. Fashion is nothing more nor less than the prevailing style at any given time. Demand manipulation frequently has as its objective the control or the influencing of fashion in the interest of individual manufacturers or merchants.

Fashion is, without doubt, the result of powerful forces in human nature. Adherence to fashion grows out of an interesting mixture of several typical feelings and emotions, such as curiosity, emulation, conformity, admiration, and conceit. Certainly, no one can belong to present-day society and at the same time be completely out of present-day fashions. A smart hat today contains the same raw material and labor that it did two years ago or will two years hence. But its style was commercially impossible two years ago and it will be impossible again two years from now.

Prediction of fashion changes must be based upon the human characteristics or tendencies which are responsible for fashions. If these inner human conditions can be stated, fashion, itself, will be more clearly understood. As a result, the direction of business will proceed with less waste and greater efficiency through the adaptation of fashion to human demands.

"Attempts to predict the new fashions before they have started is as hazardous as betting on the races. Even the most expert make a high percentage of errors. But such advance speculation is, fortunately, unnecessary for most businesses. Prompt production and sale of goods after the trends have been established will take care of the fashion requirements of the great masses of the people."[8] There are, however, certain signs which are of real value in anticipating fashion movements.

An outstanding circumstance of fashion in many lines is that change accompanies the change of season. At one time there was adequate reason for this coincidence. In recent years, however, many modern accomplishments such as central heating, closed automobiles, and heavy outer garments, have reduced the importance of change of season as a controller of fashion. Nevertheless, seasonal changes still constitute the opening and closing dates for many fashions.

"The specific motive or factors for fashion interest and fashion changes, in addition to the physical reasons for change such as occur at the end of each season, are the boredom or fatigue with current fashion, curiosity, desire to be different or self-assertion, rebellion against convention, companionship, and imitation. There may be other factors in human nature promoting fashion interest, but these are sufficiently effective and inclusive upon which to build a practical theory of fashion."[9]

The entire matter of fashion is intimately associated in the popular mind with demand manipulation. The effectiveness with which advertising and sales promotion have been used to change the trend of fashion, or to take advantage of it, is summarized by the statement that, "commercial promotion works very successfully when it goes with a fashion trend, but it has a difficult time when it works against a trend."

Marketing and the Two Aspects of Demand.—It has been pointed out that demand involves two separate, although related, phases. On the one hand, there are the *underlying economic principles* of demand, and, on the other hand, the *complexities of human behavior—psychology.*

Certain of the economic principles of demand may be restated for emphasis:

1. Demand is always related to a particular price or series of prices.

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[8] P. H. Nystrom, *Economics of Fashion,* p. 37.
[9] Nystrom, *op. cit.,* p. 81.

2. A complete statement of demand for any moment of time requires a series of conditional propositions showing the amounts which people stand ready to take at various prices. Such a series of propositions is known as a demand schedule.
3. Changes in price of different commodities are accompanied by differing proportional changes in quantity purchased. This responsiveness of purchases to price change is known as "elasticity of demand."
4. Total demand is affected more profoundly by income—or purchasing power—than by any other factor. This applies equally to world demand, and to the total demand of any individual, and to any social group or class of consumers.
5. Relative demand for specific commodities depends more largely upon the habits, prejudices and vagaries of consumers than upon anything else. These things are the result of strong human feelings and emotions, a study of which is called psychology.

The psychological aspects of demand which have been developed above may be summarized as follows:

1. All of man's choices—his desire to buy or not to buy, for instance—are influenced or motivated by a complex array of fundamental cravings and reaction tendencies.
2. In industry, goods are bought with a hope of monetary gain or profit. For that reason rational motives largely control the purchasing of industrial goods.
3. With consumer goods, on the other hand, emotional buying motives exercise the strongest influence.
4. Among the many cases in which human behavior influences purchases, none is either more striking or more important than is fashion.
5. Demand manipulation efforts are important in hastening the decisions of purchasers. It is probable, however, that few basic changes in consumer habits have been introduced by any form of sales promotion.

6. Purchases may be influenced by either primary or selective appeals.

Marketing is affected by both the economic and the psychological aspects of demand. Plans must be made, first of all, to conform with purchasing power. After that, the performance of the demand manipulation function involves an appeal to certain of the controlling forces of human behavior. The constant effort of sellers is to produce an impression in the minds of buyers which will result in a reaction favorable to the particular offering, thus leading directly to a purchase.

In the broadest possible sense, all goods, as well as all merchants, are in competition with each other. Each seller is trying to influence the behavior of possible patrons, with the sale of specific goods as the end in view. Demand manipulation is successfully carried out when buyers are persuaded to exchange purchasing power for one specific article in preference to all others.

CHAPTER 9

DEMAND MANIPULATION

Demand Manipulation as a Marketing Function.—In some manner, demand manipulation is fundamentally different from any of the other marketing functions. The cardinal purpose of demand manipulation is to bring about the consumption of goods which have been—or are to be—prepared for consumption. The process is designed first and foremost to benefit the seller, to permit him to sell more goods or to sell at a higher price. For many years it has been necessary to attract attention, arouse desire, manipulate demand, if the goods which manufacturers offer are to be consumed.

The case is somewhat analogous to that of the Iowa farmer who bought more land, to raise more corn, to feed more hogs, to get more money, to buy more land, and so on, ad infinitum. In the case of demand manipulation, the consumer is urged to buy more goods, so that the producer may make goods, so that more income may be distributed, so that consumers may buy more goods, and so on, until we are in danger of being swept away by an avalanche of *goods*.

None of the other marketing functions are like this. They are all concerned with bringing things to the consumer where and when he wants them, in convenient form, and at the lowest price consistent with courteous, convenient service.

The economist defines "production" as any activity which results in the satisfying of human wants, i.e., as the creation of utilities. Human wants are, in some measure, satisfied directly by all the other marketing functions. Demand manipulation, in contrast, aims to *arouse* wants, to cause people to desire things which they may never have heard of before.

Therefore, while distinctly useful, demand manipulation is not in all cases directly productive, although indirectly it may be highly productive.

Methods of Manipulating Demand.—Demand manipulation may be accomplished either through personal selling, through advertising, or through any form of sales promotion. General publicity, window displays, direct mail solicitation, newspaper and magazine advertising, house-to-house canvassing, traveling salesmen, and retail store selling, are among the methods in common use. The choice between the various methods is based on comparative costs of accomplishing a definite sales program.

Marketing research is frequently undertaken as a guide to demand manipulation activities. The potential market may be defined and measured through market forecasts; the most effective sales appeals may be determined through market analysis; cost studies will indicate the most economical method of obtaining a desired result. All of these together will determine the extent to which intensive selling is expedient, as well as the methods best suited to the particular case.

What May Be Accomplished by Demand Manipulation.—Demand manipulation may accomplish any of several different things:

1. It may bring about a direct increase in sales of the advertised product. California oranges, Chesterfield cigarettes, Ivory soap, Wrigley's chewing gum, Campbell's soup, and many other commodities have been "made" by intensive sales promotion. There are many conspicuous cases: the Hartford Insurance Company is said to have sold 10,000,000 policies as a result of an effective mail campaign; an oil burning furnace company claims to have increased its sales 175% by one year of newspaper advertising; a valve manufacturer is said to have increased his business 500% in five years of intense magazine advertising; Chrysler took the Maxwell car at a time when

its sales were nil and built them to a huge figure by effective sales promotion. In fact, all nationally distributed goods probably owe their widespread adoption to successful advertising. This is the first and obvious result of sales promotion or demand manipulation.

If a sales campaign is successful, it must cause a real increase in demand[1] for the particular product. And it is only when an increase in demand is brought about that demand manipulation efforts accomplish the desired results.

Not all changes in demand are the result of conscious efforts to manipulate demand, however. Some things are accepted by the public so rapidly that sales promotion never even catches up, to say nothing of "manipulating" demand. Radios, Fords, short hair, and shorter skirts were each in this class for some time. Frequently, with new specialties, manufacturers are unable to fill orders, not because of sales promotion, but because the fad or fashion is as catching as the "flu."

2. Demand manipulation may bring lower selling prices if it makes possible the economies of large-scale production. Up to a certain point, it is generally true that unit costs decrease as size of plant increases; this is true because of savings that may come through greater efficiency in operation, because of division of labor and introduction of better machinery, and because of savings in the purchasing and selling departments.

Large-scale production can be supported, however, only by a wide market, which means that intensive selling must be resorted to in order to tell the consuming public about the product. Present-day transportation is so effective that a producer may sell throughout the nation—even throughout the entire world—if his product has been widely advertised, and if a market has been developed.

A product which meets the fancy of the consumers may, therefore, decrease in price, if successful demand manipulation develops a wide market and enables large-scale production to lower costs.

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[1] As defined in Chapter 8.

3. Demand manipulation may reduce waste by making consumption more nearly conform to production, through the development of desire for the specific things which have been produced. As pointed out in the discussion of risk, goods are produced before the desires of consumers are fully known and, as a result, some things which are made go begging for a market. If people can be persuaded to use such goods, the social effort which went into their production will not have been expended in vain.

4. Demand manipulation facilitates buying, through telling the public what is for sale and where it may be found. In fact, sales promotion, and especially informational advertising, are often spoken of as educational devices. The principal ways in which sales promotion may be educational are as follows:

(a) Methods of use of product, including its own care and upkeep.
(b) Announcement of new products, new inventions, new processes.
(c) Announcement of new uses for old products and of improvements.
(d) Announcement of a product to a market where it has not previously been available.
(e) Announcement to the constantly changing public, i.e., the people who are just becoming old enough to make use of a product.
(f) Listing of the place where the product may be had, and explanation of the method of purchase and sale.
(g) Information concerning stocks on hand and tendencies in supply and demand.
(h) Style changes and trends.
(i) The popularizing of a new custom as a part of the standard of living.
(j) Objective measurements of performance.

5. Demand manipulation may largely contribute to the development of civilization. Gibbon, in his History of Commerce in Europe, puts it this way: "The history of commerce is the history of civilization, the history of human wants, and how men have at various times satisfied them. In some countries men have not felt any needs at all beyond the one paramount necessity of gaining the means of life itself; and, having done this, they are satisfied. In this state they remain for centuries, never progressing and never wishing to progress. Such nations are found everywhere among the inferior races of the world. But there are other races who are not satisfied with the mere necessaries of life; they require something more than mere food and clothing; they require comfort and variety, even luxury, in their surroundings, and if they only feel these needs strongly enough, they generally can satisfy them. But real civilization is never satisfied, for no sooner has one want been fulfilled than others seem to arise, and so we get that continuous development of varying needs of various people which modern commerce tries to supply."

In general, people desire to consume more only after they are "educated to a higher standard of living." Advertising and related forms of sales promotion are the tools available for educating the masses both mentally and emotionally. As a result, advertising and its allies become an important force in social progress.

6. Demand manipulation may help to stabilize industry. Most enterprises are subject to fluctuations in prosperity; business is sometimes good and at other times it is poor. Whenever a business depression occurs, it may mean operating at much less than full capacity. Stocks of goods pile up, perhaps to be sold later at a sacrifice. Such ups and downs in business activity are likely to cause considerable waste and loss to the individual firms.

Advertising is one of the tools frequently used to reduce these wastes. By intelligent planning of sales promotion, and by intensive advertising during periods of business inactivity, the ups and downs can be reduced materially. Some businesses budget their advertising expenditures so that intensive demand manipulation effort can be resorted to if purchases fall off to any considerable degree. This is strikingly indicated by the following table showing expenditures for magazine space during the depression beginning early in 1920.[2]

Table of Changes in Magazine Advertising
Expenditures for 1920 = 100%

Firms	Relative Expenditures		
	1920	1921	1922
Hart, Schaffner and Marx	100%	150%	155%
Postum Cereal Company	100	120	160
Palmolive	100	125	150
Valentine and Company (paints)	100	120	150

As the table indicates, these firms attempted to meet the falling off in sales by greater advertising efforts.[3]

7. Demand manipulation, when in the form of widespread advertising, tends to prevent multiplicity of prices. Many advertisements for nationally distributed products quote the retail price, so that consumers everywhere become familiar with the selling price. For example, Campbell's soup is advertised everywhere (by the manufacturer) to sell for 12 cents per can.

8. Advertising may, for some commodities, accomplish for consumers' goods what the organized exchanges accomplish for certain raw materials, namely, bring all buyers in touch

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[2] Data from monograph of the Crowell Publishing Company, *National Markets and National Advertising*, 1925.

[3] A table could be constructed to show the reverse policy followed by certain other firms during the same period. For example, Kuppenheimer and Quaker Oats decreased their magazine advertising by one-half in 1921 as compared to their 1920 expenditure. Other cases could be cited to show the same tendency on the part of many firms toward *decreased* advertising when income is materially reduced.

with all sellers. All sellers of the various brands of a commodity may advertise nationally, so that their offerings may become known to all prospective buyers. Since the branding of advertised goods carries an implied guaranty of quality, the consumer has the opportunity to evaluate more accurately the comparative offerings.

Some Arguments Against Intensive Demand Manipulation.—There are many arguments advanced against intensive efforts at demand manipulation:

1. Many industries have already reached the stage when any increase of output will result in a higher average cost per unit. In such cases one of the favorite arguments for sales promotion is really fallacious. It might be better for all concerned, for example, to open a new unit store in another locality and serve such clients as will come to it without intensive sales activity than to undertake the expansion of sales from an existing store.

2. There is danger of partial monopoly. The branding of a commodity implies that it is somehow different from other commodities and that, therefore, it has a value all its own. Sometimes this impression prevails so strongly that a commodity may be sold at a price much higher than that paid for identical items sold under different names.

3. There is waste due to an incomplete use of consumers' goods. It is a well-known fact that the wardrobes of women are filled with good clothing which they do not wear because it is out of style. Or again, the American Association of Wholesale Opticians appointed a committee a few years ago to urge the public to wear eye-glasses suitable for the occasion on which they were worn; one pair for business wear, another for sports, another for evening, and so on. A series of advertisements undertook to create the conventional belief that other than the designated type was out of place on each occasion.

4. People are persuaded to buy when, cost and need for other things considered, they should not. "Nowhere does the

domination of men by their institutions appear more conspicuously than here where we see an impressive array of specialists —advertising copy-writers, press agents, artists, psychologists, salesmen, window dressers, and others—making it their life work to shape men's desires in the interest not of mankind but of business.

"Not only does business influence men's expenditures by molding their desires, but it affects their purchases even despite their desires and often in direct violation of them. The work of many marketing specialists—particularly those pushing display goods—may be likened to the maintenance by a farmer of a carefully watered mud hole in the road passing his farm, that he may collect from passing motorists for hauling them out of it. Marketing experts do not merely create desires which can be satisfied only by the goods which they are pushing, but they also create pains which can be avoided only by purchasing the goods. As rapidly as they can, they persuade those consumers who compete most strenuously to adopt new styles. As the new fashions are established, other buyers, who would perfer to consume at a slower rate, feel compelled to discard goods of the previous style and to purchase the new. Their motive is less to gain pleasure than to avoid the discomfort of being out of fashion. It is not, of course, asserted that the competitive consumption which forces this reluctant and unwilling buying is solely the creation of business, for it is found among primitive peoples. Nevertheless business both greatly quickens the rapidity with which style changes occur and increases materially the sums spent for display. It would be interesting and important to know just in how far the demand for display goods is determined not by desire for the articles but by the competitive pace which marketing experts are ever endeavoring to accelerate and over which, as the arts of salesmanship and advertising are perfected, they are steadily acquiring more and more control."[4]

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[4] S. H. Slichter, *Trend of Economics*, pp. 310–313.

5. Advertising often creates false values in the consumers' minds. It is well known that if a statement is repeated often enough, many people accept it as true. That applies as well to statements about worthless fat reducers and injurious "dope" as about the "best machine in the world." The advertiser is more interested in selling than he is in consumer welfare. If the advertiser is selling a water softener, for instance, he may accomplish his object with the slogan "hard water has ruined more hands than has hard work." Such a slogan has an appeal when the consumer does not remember—and there is no one to remind him—that no water is harder than sea water, and no water is better for the skin! Men will not forego the use of emotional blandishment when to do so is to forego profits as well.

6. While the policy, "let the best man win," may be good in most cases, it may not always be so in competitive industry, especially if one party makes use of unscrupulous advertising to oust a rival. For food products, particularly, the increased demand for one product is usually accompanied by a decrease in demand for something else—since the capacity of the human stomach is limited. Advertising is not concerned with what happens to competitors—except as it may incidentally ruin them—so long as the product advertised becomes a success. Hence, while advertising may bring increased sales and lower costs for one firm, it may have the opposite effect on another.

Social Versus Individual Viewpoint.—From the statements above, it is seen that demand manipulation with its most important weapon, advertising, is a highly controversial matter. This condition grows largely out of the fact that in this problem, as well as in so many of our economic problems, there are two opposing viewpoints from which to judge performance. These are the *social* and the *individual.*

Looked at from the *social* point of view, it appears that the consumer is subject to a veritable barrage of advertising, telling him about the superior advantage of one out of several dozen brands of a commodity. It has been said that in America one dollar is spent to tell consumers about goods which they may or may not want to buy, for every seventy cents spent for education.[5] The consumer is told by a tobacco company to "Reach for a Lucky Instead of a Sweet," with implications as to the fattening effect of candy; the candy sellers retaliate with a statement about the harmful effects of tobacco. A consumer becomes the proud possessor of a new automobile, only to be told in a few weeks that he is out of style unless he gets the latest "improved" model. An otherwise plain commodity is put in a fancy package—and sales mount. Examples could be multiplied to show the pressure put upon the consumer through advertising and other demand manipulation activities.

Further, demand manipulation uses much human effort. It is said that over one and a quarter billion dollars is spent annually for advertising. In 1913, the Procter and Gamble Co. was the largest advertiser in magazines, spending that year $705,000 for magazine space alone. In 1927, fifteen years later, this company was again the largest user of magazine space, spending $2,703,000 for that purpose. This increase is typical; the 75 leading users of magazine space in 1913 spent a total of $10,400,000 for the purpose, while in 1927 the 75 leaders had increased their expenditures to $55,800,000. In the latter year, 11 individual advertisers spent over $1,000,000 each for advertising space. Also, in that year nearly $24,000,000 was spent for advertising food products in magazines, $22,000,000 by the automotive industry, $21,000,000 for drugs and toilet goods, $15,000,000 for furniture and furnishings, and $7,900,000 for clothes and clothing.[6] These huge expenditures are accompanied by much effort on the part of copywriters, layout men, account executives, research staffs, artists, and printers, to say nothing of paper and ink manufacturers, and so on. People so employed cannot use their energies in the production of tangible commodities. The social worth of all this expenditure for advertising depends upon whether it adds more to the total product of society than could be obtained if the same effort was differently expended. The answer to this question depends upon how one measures "the total product of society" and "welfare of consumers."

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[5] Stuart Chase, *Tragedy of Waste*, p. 124.

[6] *National Markets and National Advertising*, Crowell Publishing Co., 1928.

There is, however, the *individual* point of view from which to judge intensive demand manipulation. Marketing is a personal and individual business affair; acquisitiveness, or private gain, is the end and aim of each undertaking, when considered from this point of view. In the buyers' market, where the consumer is king, intensive selling becomes a prerequisite to success. The new competition is not only a battle between individuals, but a battle between industrial giants—the tobacco against the candy industry, the lumber industry against those of other building materials. All the selling forces must be marshalled if the hoped-for sales quota is to be achieved. For the individual, therefore, sales promotion and effective advertising appear to be the only alternatives, both for defensive and offensive purposes. So far as *he* is concerned, Mr. and Mrs. Consumer must be educated to buy *his* products or buy at *his* store, rather than to buy other products, or buy elsewhere.

Differences between Commodities.—It would be foolish to assert that advertising and other forms of intensive selling will accomplish the same immediate end in all industries and for all products. In the first place, advertising which is not backed by truth and quality can hardly succeed for any great length of time, except, possibly, with those commodities for which the consumer has no method of objective evaluation.

In the second place, it must not be forgotten that back of successful sales promotion is usually a product which meets the approval of consumers, from the standpoint of current desires. Many intensive sales campaigns have *not* been successful. For example, ostrich farms have failed in spite of continuing effort to sell plumes for hats and as other decoration; Cluett Peabody reorganized as a result of near failure when their advertising campaign failed to prevent the adoption of soft collars.

In the third place, some distinctions exist with respect to the degree and ease of expandability of demand. The consumption of some commodities, such as cigarettes and radios, can be expanded more easily and more widely than can the consumption of some other commodities, such as wheat and coal. Among the factors which influence this variation are the number of alternative products giving the same general satisfaction, the number of uses for a specific commodity, and the question as to whether the commodity is a necessity or a luxury. The limits to increased demand for luxuries are purchasing power and human vanity, while necessities are frequently limited by their specific need—for foods, for example, by the capacity of the human stomach. To be sure, there is a vast amount of substitution possible for each class of goods, so that even the manufacturer of a new type of breakfast food may be able to manipulate demand for his product, to the detriment of some other manufacturer of breakfast food. But even if that be accomplished, the desire for variety prevents any wholesale manipulation of demand in favor of a particular type of food.

Who Performs the Demand Manipulation Function?—Demand manipulation is found throughout the entire marketing process. Producers of raw materials, manufacturers, wholesalers, and retailers, all undertake to increase the quantity of their commodity which will be taken at a price. As pointed out in Chapter 3, the direct demand for consumer goods governs all demand. The demand for other than consumer goods is either derived or reflected from the consumer situation. Consequently, all business is interested in the manipulation of consumer demand. This fact has been influential in the integration of business as discussed in Chapter 21.

Among those who are directly engaged in supplying goods to the consumer market, there is a vigorous controversy as to who shall manipulate demand—the merchant or the manufacturer.

If attention is to be directed toward any particular product, that product must be named or branded so that it may always be identified. Hills Brothers' coffee, Colgate's tooth paste, Holeproof hosiery, Silvertown Cord tires—to mention but a few items—are identical, whether purchased in New York, Minneapolis, or Los Angeles.

A principal accomplishment of branding merchandise is the implied guaranty that quality will be kept constant. Manufacturers maintain that they are the only ones in a position to test thoroughly the quality of their products and thereby maintain a standard. Consequently, there is a long list of manufacturers' brands which are advertised nationally. Often a retailer will carry 25 or more brands of toilet soap, a dozen brands of coffee, and so on, all of which carry the implied guaranty of quality supported by the manufacturer. Over $200,000,000 are spent annually by manufacturers for magazine advertising alone in the attempt to turn demand toward specific brands.

All of this tends to bewilder the consumer, who certainly has no satisfactory method of comparison between the offerings. Some merchants, therefore, maintain that it is properly their function to choose between the products of various manufacturers and to put their stamp of approval on the goods which they sell. This leads to the policy of stressing "private" or merchants' brands, a policy which is adopted by some wholesalers and many department stores.

For certain commodities—canned peas, for example—the merchant is in a better position to guarantee quality than is the manufacturer. If the pea crop in the vicinity of a cannery happens to be poor, the grade put out by that plant will be low and the canner's brand for that season will be below standard.

A merchant, on the other hand, may change his sources of supply more readily and may thus maintain a more uniform pack.

If the cost of leather and of labor increases, the quality of shoes which a manufacturer makes to retail for $10 may be lowered. Here, again, the manufacturers' brand fails to be a guaranty of quality. When costs are fluctuating, with a resultant effect on grades, it is probable that competent merchants can choose between manufacturers' offerings with greater accuracy than can consumers.

These random illustrations suggest that if demand manipulation were in the hands of merchants only, the consumer might be more intelligently advised than he is at present. Chain stores are giving a new impetus to merchants' brands and merchants' advertising. Moreover, they are undertaking, in many cases, to give exact specifications of quality to manufacturers. To the extent that merchants can reduce the number of brands offered to the public, between which there are no differences except brand name and color of package, to that extent, at least, they will have definitely benefited consumers.

CHAPTER 10

MARKET PRICE

Price Is the Regulator of Production and Consumption.—Price is the value of a commodity expressed in terms of money and is established in the market by bargaining between buyers and sellers. A commodity which is wanted by many people, and which is very scarce, will usually command a high price. Goods which are abundant, and for which the desire is not particularly urgent, usually sell for a low price. Greater desire for a certain good means spirited bidding by buyers, and a resultant higher price; this higher price usually will attract greater supplies of the commodity to the market, after which the price falls again. Price is thus the regulator of production and consumption. One important activity of marketing institutions is, therefore, the crystallization of a market price, and prompt reporting of that price. Production and consumption

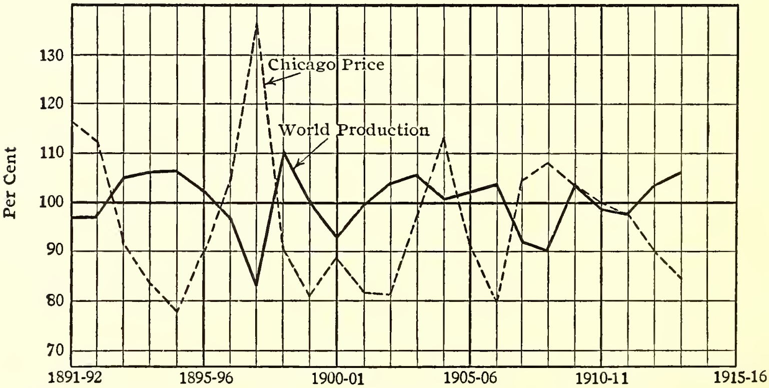

Figure 5. World Wheat Production and the Chicago Price, 1890-1891 to 1913-1914

This graph illustrates a typical relationship between production (supply) and price. When the supply is relatively large, the price is correspondingly low—and vice versa. (From U. S. D. A. Yearbook, 1923, p. 98.)

are guided by price; dealers in the market base their activities on prices, past and expected, and must, therefore, have accurate and reliable information.

In a "perfect market" competition would bring about a single price for any good at any one time and place. Such a price would then reflect all known conditions of production and consumption, and would be a complete guide to economic activity.

Difficulties of Determining Market Price.—If one examines actual prices paid for a commodity in any market area, however, it is noticed that no one single price prevails at any one time, but a series of prices, although the articles sold may be identical in all respects. For example, all retail stores do not sell like goods for the same price; tobacco of identical grade sold on the auction floor brings widely differing prices; produce brought to city markets does not all bring the same price, although no apparent differentiation can be made as to quality. To be sure, there is often a justified difference in price, since one dealer may be giving more satisfaction than other dealers. For example, a retailer selling goods on credit and delivering them to the consumers is selling the goods *plus* a valuable service which must be paid for. Furthermore, better service in waiting on the trade, or in the fullness of the stock carried and the resulting opportunity for comparing qualities in a given store, is worth an extra charge to many patrons. When comparing prices in various outlets, therefore, it is important to take into account all the services and concessions granted by each one.

Furthermore, one cannot speak of the price of a commodity without some reference to grade; the "market price of wheat" on any one day may range from one dollar to two dollars per bushel depending upon the grade referred to. With many commodities comparison is not even possible, since standards are different; this applies, for example, to certain agricultural commodities, such as eggs and butter, and to certain style goods, such as women's millinery.

The reasons for these price variations are many: some sellers have an undue advantage in bargaining power; quite often buyers know neither relative values nor possible supply sources; marketing organizations may fail to function properly, causing temporary gluts and scarcities.

A further difficulty in identifying market price arises from the fact that quotations on many products are not based on actual sales, but represent merely the opinions of dealers as to the most representative market price for that day. Quotations on eggs and butter reported by certain New York dealers are made up in that manner.

It is readily seen, therefore, that one cannot with any propriety speak of, nor categorically define, any one price as "the market price" of a certain good. The market price, in many cases, instead of being definite and definable, is rather a series of prices for like goods—and for varying grades—in any market area.

Market Quotations.—The result is that quotations sent out are not always accurate or representative of actual prices paid in the market. In the case of most farm products, for example, the quotations give the *range* of price during the trading period as illustrated below:

Wheat—No. 1—dark northern...........	$1.34 @ $1.38
Butter—extra firsts.....................	.35 @ .36
Veal—fair to good.....................	.15 @ .18
Squabs—nesters, dressed, fancy, dozen....	.50 @ 3.50

In other cases the quotations are based on the *average* price for the day or month. A figure taken to represent the market price for any period of time may be the lowest or the highest price paid, or simply the average, hence not representing any particular sale. For instance, the wheat price shown above might have been quoted as $1.34, as $1.38, or as the average of the two, $1.36.

It is of importance to know what the quotation actually represents, because both buyers and sellers are guided in their policy by prices in the market. The price system carries the responsibility of keeping our competitive economic order working with automatic precision. Smooth functioning of the marketing institutions cannot be expected unless the prices reported are indicative of actual trading conditions. The most valuable type of price quotation for specific commodities may have to be determined by the dealers in that commodity, but *accuracy* and *representativeness* will always be required.

Market quotations also frequently include a statement of the terms of sale. For many commodities this includes the length of time before payment must be made and the amount of discount for cash. For example, the terms usually quoted in the wholesaling of groceries, automobile accessories, electrical supplies, and many other lines, are 2/10 net 30; which means that a discount of 2% from the quoted price will be allowed if the bill is paid within 10 days of the date of invoice, and that interest will be charged on any unpaid balance after 30 days from date of invoice. Terms so quoted are called "ordinary" terms and they range in liberality at least between 1/10 net 30 on imported cigars and 6/10 net 60 on braids and ribbons.

There are many variations from these "ordinary" terms. Sugar, for instance, is commonly quoted 2/7 R.O.G., or 2% discount if paid within 7 days of the *receipt of goods*. Or again, the terms may be C.O.D., in which case payment is strictly cash. Cash may also be collected by use of the terms S.D.-B.L., which means that a sight draft must be honored by the buyer's bank before the goods are delivered by the railroad. Such cash terms are generally used for poor credit risks. For "running accounts," where frequent small purchases are made throughout the month, the terms may be E.O.M., or M.O.M. That is, the credit extension and discount periods will begin at the end or the middle of the month for all goods shipped in the previous period, rather than on the date of the individual invoices. These are among the more common terms in current use.

Such terms are an important feature of price quotations. For instance, the cash discount in the ordinary terms of 3/10 net 30 offers a premium for prompt payment which amounts to an interest rate of 54% a year; this becomes an important saving when compared with C.O.D. terms. Moreover, the difference between "ordinary" and R.O.G. terms may be of considerable importance when competition is between local sellers and those located several freight days away.

One further aspect of price quotations is found in trade discounts. Manufacturers frequently quote a base price which, in reality, is their suggestion for a retail price. They then establish various discounts which they allow to different classes of middlemen. For instance, an article may be quoted to a retailer at $10.00 less 25%. The same article may be quoted to a small wholesaler at $10.00 less 25%, less 10%; to a large wholesaler at $10.00 less 25%, less 10%, less 5%; to a district distributor at $10.00 less 25%, less 10%, less 5%, less 5%. That is, $7.50 would be the cost to the retailer; the small wholesaler would pay $7.50 less 10%, or $6.75; the large wholesaler would pay $6.75 less 5%, or $6.41; the district distributor would pay $6.41 less 5%, or $6.09. Each buyer is interested in obtaining as long a chain of discounts as possible and there is constant effort among middlemen to be placed in the most-favored class.

Promptness of Price Reporting.—It is also necessary that price information be sent out promptly. One of the tests of an efficient marketing system is the rapidity with which supplies are adjusted to price changes. One market should not be glutted while another experiences a shortage. Since a higher price generally will bring more goods to a particular market, and a fall in price will check the supply, price adjustment as between markets depends on the accuracy and rapidity of price reporting. One has but to compare "covered wagon" days with our present era of telegraph and radio to note the improvement in market adjustments following the improvements in communication.

At present, much price information is sent out daily—and oftener—over the radio, thus informing producers of the relative profitableness of shipping goods to various markets. The problem as to *where* to sell, which generally depends upon relative profitableness, has been much simplified by our present rapid means of reporting price information.

Price quotations are, of course, but one part of market quotations. The latter include estimates of supplies, both immediate and future, and of sales or realized demand.

Price Movements.—A survey of any time series of prices may reveal at least three types of movements: (1) a trend, or tendency to change in a given direction, (2) cyclical changes, or more or less regularly recurring ups and downs, and (3) seasonal variations, or changes recurring annually. For example, livestock prices may show a gradual upward or downward tendency over a long period, also a regularly recurring change every two or three years, and, finally, a regular month to month change during the year. In the aggregate, these price changes are of importance in marketing because of the relation between price and sales, or realized demand, as pointed out in Chapter 8.

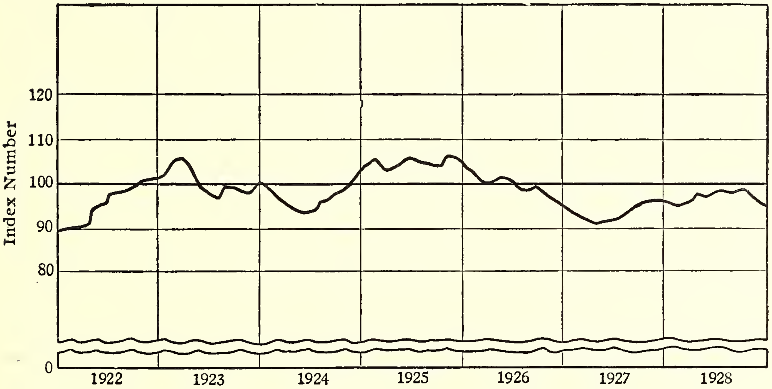

Figure 6. Index Numbers of Wholesale Prices in the United States

This graph illustrates the cyclical or recurring nature of price fluctuations. The data here depicted are an average of prices for all commodities. Past cycles of prices in the United States have varied in length from about 2 years to over 8 years. (United States Bureau of Labor Statistics, Revised Index, 1923-25=100.)

Trends and cyclical price movements are in part predictable. To the extent that this is possible, they do not constitute a serious marketing problem. Unfortunately, no perfect method of forecasting has yet been devised. The influence of unpredictable price movements will be referred to again in the chapter on market risk.

Seasonal Price Movements.—Seasonal fluctuations in prices occur principally with seasonally produced commodities. In some cases, such goods are produced during a short period each season, as is the case with wheat in the United States. For others, as for instance eggs, production is continuous throughout the year, but in widely differing quantities per month.

If storage facilities were available, and if judgment as to quantities which should be stored were perfect, the seasonal differences in price would reflect only the cost of carrying. That is, wheat prices, for instance, would rise throughout the season by the amount of storage charges, as indicated in the accompanying diagram.

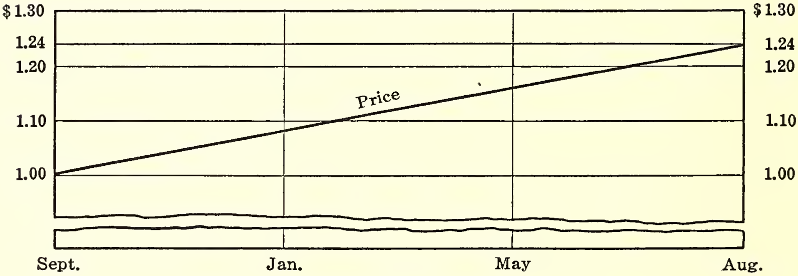

Figure 7. Ideal Seasonal Price Changes

Two assumptions are implied in this diagram, namely: (1) The costs of carrying grain—including storage charges, interest, and so on—are 2 cents per month, which fact determines the slope of the line, or the increase in price from one period to the next. (2) A price of $1.00 at the beginning of the assumed crop year, increasing to $1.24 for the final month, will stimulate a total consumption just equal to the total commercial crop.

In the case of a seasonally produced, storable crop, such as grain, the entire season's supply is estimated against the entire demand. That is, the relationship between the early-season and the late-season prices should remain the same, regardless of the actual price level. For example, the price may shift from its range of $1.00–$1.24, as given, to $0.90–$1.14 if the supply is unusually large, or to $1.15–$1.39 if the supply is small; but, in a perfect market, the spread between prices on different dates will remain constant. No one would hold grain to the future date unless an increase in price could be expected so as to pay the cost of carrying it; no one would sell at the beginning of the season at a cash reduction from the expected future price which was greater than the cost of holding.

This assumed seasonal variation in the price of wheat—or of any similar commodity—is not exact in actual experience. The assumptions of a "perfect market" are absent from marketing organizations. Complete knowledge of demand and supply conditions is not available at the beginning of the season, so that the opening price is either too high or too low to bring about the desired balance between production and consumption. Such imperfections bring about loss—or exceptional gain—to the people who undertake the storage function. Another reason for the divergence of the actual from the theoretical seasonal price is the fact that all economic activity is subject to "friction," that is, there is a lag in response to given stimuli. To complicate the situation further, there is often manipulation of prices by some influential dealers who possess either informational or bargaining advantages.

Perishable Commodities and Seasonal Price. Eggs and butter, although produced during the entire year, are stored in large quantities. They both show characteristic seasonal fluctuations in price. From April to June, inclusive, the production of eggs is much greater than ordinary consumption requirements, while during the winter months production is relatively small. The seasonal price of eggs shows an almost perfect inverse relationship with this production movement, as indicated by the following diagram. Prices rise fairly high during the winter months, but they would rise still more if the supply of storage eggs was not available. Part of the rise is due to scarcity of *fresh* eggs, and part of it to the cost of carrying *storage* eggs.

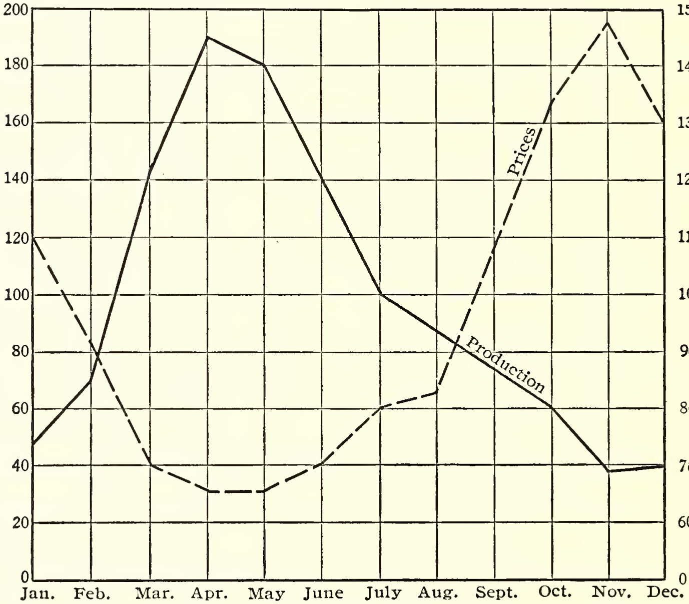

Figure 8. Seasonal Index of Egg Prices and Egg Production in the United States, 1910-1925

The price of butter exhibits similar tendencies, although the rise in price from spring to winter is not so great as with eggs. The reason is probably found in the fact that storage butter and fresh butter are more nearly comparable than are storage eggs and fresh eggs. In this particular, butter is more like wheat.

Variations from the assumed "normal" relationship of seasonal prices occur for both butter and eggs. These variations are partly accounted for by the reasons discussed above for wheat. There is the further fact, however, that both of these products are perishable and are subject to spoilage, which increases the spread between prices at the beginning and close of the season.

There is still a further fact which is operative with all commodities to make the spread either greater or less than the costs of carrying. If the price during months of heavy production is high, due to a short total crop, many people will expect a less than normal rise, and will sell heavily. This will tend to cause a shortage at the close of the season, with a resultant spread which is more than usual. Conversely, if there has been a large crop and the opening price is lower than the recent average, there is a tendency for a larger amount to be held in hopes of a rise. The result is that the close of the season finds a more than normal proportion of the crop remaining, so that the customary seasonal increase in price is not realized.

Non-Perishable Commodities and Seasonal Price. Some non-perishable commodities, although seasonally produced, do not show any close correspondence between production per month and price. Certain types of clothing are seasonally produced and yet the price movements reflect conditions of demand rather than of supply. For example, the retail price of overcoats is usually the highest during the fall months, when the supply on the market is the greatest. With such commodities it is often possible to control production to such an extent that there is little or no seasonal change in price in spite of a high degree of seasonality in production and consumption.

Importance of Seasonal Price Movements. It is important to distinguish between seasonal movements of price and changes due to other than seasonal causes. As already pointed out, seasonally produced goods show certain characteristic price changes, due to annually recurring changes in demand or supply. A fall in the price of eggs from February to

April is expected, and will be taken into account by the experienced dealer. It is the departure from expected seasonal movement which gives concern to men engaged in the trade. A rapid rise or fall in prices during one year may be attributed to seasonality, when in reality it may mean that prices are actually moving to a higher or lower level. Such false assumptions regarding price adjustments may lead to faulty storing, and result in losses to storers, producers, and consumers alike.

Regional Differences in Prices.—Difference in prices between various localities should reflect only differences in cost of transportation, just as time differences should reflect only storage costs and waste.

The performance of the assembly function is primarily responsible for distributing goods to each market in the right quantities. Quite often, however, too much of a perishable commodity is sent to one market, and not enough to another; since such products cannot always be reshipped, prices may vary markedly between places not very far apart, regardless of transportation costs.

The price of other commodities may vary between markets because of peculiar demand conditions. For example, brown

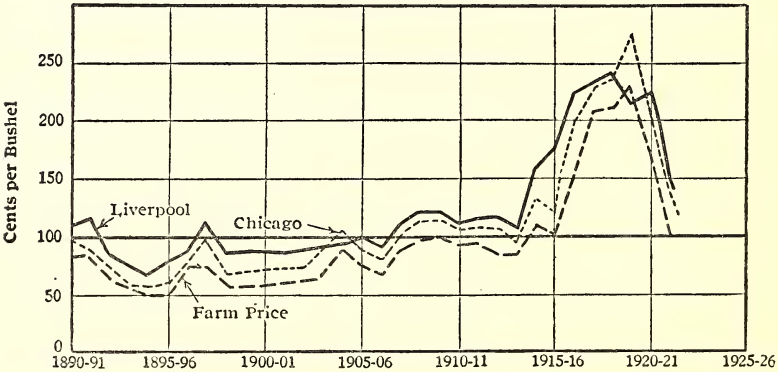

Figure 9. United States Farm Price of Wheat and Wheat Prices at Chicago and Liverpool, 1890-91 to 1921-22

This graph illustrates the typical spread between prices for the same commodity in different markets. This spread is due largely to transportation costs. Any divergence from customary spread has some other temporary explanation. (From U. S. D. A. Yearbook, 1923, p. 99.)

eggs usually command a premium in Boston, whereas in New York they are subject to a small discount, small lemons are at a discount in most markets, although the Dallas trade seems to prefer them.

Cases are also found where the price of a commodity is the same in markets over a wide geographical area, regardless of transportation costs. This is frequently true with branded consumer goods, such as Campbell's Soup or Gillette Razors. This may be due to the small part which transportation plays in the total costs, or it may be due to the manufacturer's attempt to standardize the resale price for advertising purposes.

Abnormal differences in prices between localities may be due to peculiar monopoly conditions. An illustration is the celebrated "Pittsburgh Plus" price system prevailing some years ago in the steel trade. Further, it is possible for a concern to charge unduly high prices in territories where competition is absent, and lower prices where active competition is found.

Differences in customs and habits of the population may also account for abnormal price differences between localities. This cause is of minor importance in this country, however, as compared with Europe, where such variations often are found within a short radius.

For the majority of goods, however, regional differences in prices do reflect approximately the transportation costs between markets. In the central markets, where goods can be bought and sold on contract, certain dealers are constantly engaged in watching prices in the various markets. These dealers are quick to take advantage of opportunities to buy in a low market and sell at once in a high one, whenever any abnormal price spread exists. Such dealers are known as "scalpers" and the business of trading the low against the high market is called "arbitrage." Grain and cotton merchants frequently make a careful study of the arbitrage business with the idea that they will always have at least a part of their selling contracts in the highest market and a part of their buying contracts in the lowest market.

The importance of adequate and accurate price information should again be emphasized. The difference of a few cents per unit will often divert large quantities of a commodity from one market to another. But, if the difference is apparent rather than real, improper distribution and poor functioning of the marketing organization may result.

Producer, Wholesale, and Retail Prices.—The prices referred to so far are prices in the central, or wholesale, markets. Most commodities may be said to pass through two other markets. They are the producer or raw material market, and the retail market for consumer goods.

A comparative study of the prices of related articles passing through these three markets, as for instance wheat, flour, and bread, shows a marked difference in behavior. In general, the price level of a raw material, such as iron ore, wheat, or cotton, does not coincide with the level of corresponding wholesale and retail prices. The underlying movements from period to period may be the same but there are two characteristic differences.

In the first place the *magnitude* of the fluctuations is usually quite different in the several series, being greatest in the case of raw materials and least in the case of retail prices. In fact, retail prices for many commodities change but little except during special "sales." For example, the retail price of bread often remains the same for a year or more, while any changes which do occur are usually slight. The central market price of wheat, on the other hand, changes from hour to hour and changes of 30% in three months' time are not exceptional.

In the second place, the *time* of fluctuations is different. In general, changes appear first in the raw material or producer market, then in the wholesale market, and finally in the retail market. Many of the smaller changes in the price of raw materials are never reflected in retail prices but are absorbed as profit or loss somewhere in the chain of business activities.

These differences in magnitude and time of price movement in the different markets require some explanation. There are, in general, two sets of circumstances under which supply and demand relationships change sufficiently to bring about a change in price. These will be considered separately.

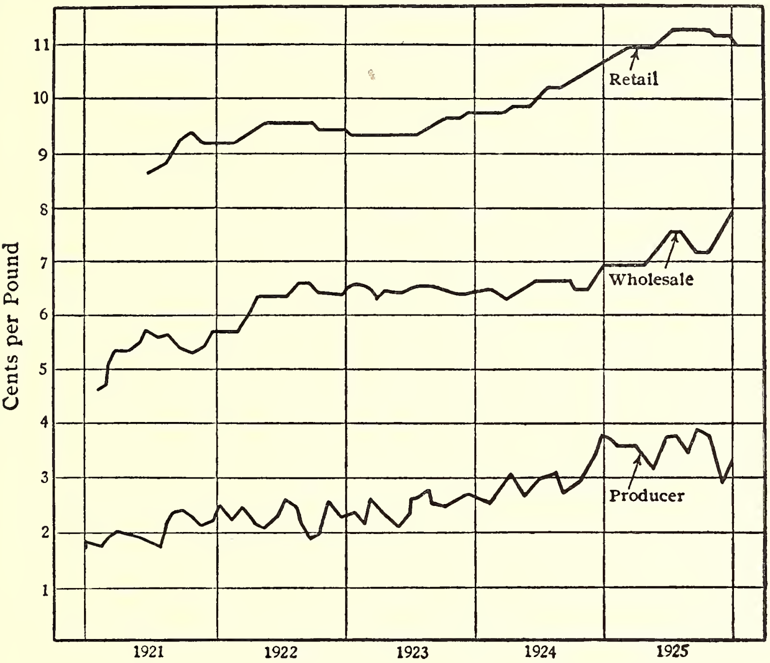

Figure 10. Producer, Wholesale, and Retail Price of Rice

This graph illustrates the difference in fluctuations of prices in the three markets. Each series is commenced just after the extreme slump following the war. It will be noted that the producer price reached the low point earliest, and the retail price reached it last. The fluctuations are most frequent and most violent in the producer market, and least so in the retail market. The spread between the prices represents the cost of processing and marketing. Each of the series has a distinct upward trend during the period. (Data from U. S. D. A. and Bureau of Labor.)

(1) In the producer's market the supply of some commodities, including all agricultural products, fluctuates widely from year to year. Frequently these fluctuations are not called out by a change in consumer demand. They may be due to the weather complex, the discovery of a new oil field, a labor strike in the coal mines, or other similar circumstance. Such a change

in supply should affect prices, at least in the producers' market. If the crop of wheat, for instance, is unusually large and there has been no corresponding increase in the demand, the wheat can be passed to the millers or other dealers in the central market only at a reduced price. This will be the *first* price change. *Later,* wholesale flour prices may decrease due to the lower cost of raw materials; but the decrease will not be as great as that in wheat prices because the raw material cost is only one part of the flour cost, labor, interest, and so on, making up the remainder. *Finally,* the price of bread will, perhaps, decrease slightly, but not even proportionally to the change in wholesale flour prices. The cost of flour is only one-third of the baker's total costs and, therefore, if other costs remain the same, the cost of bread will change only about one-third as much as the cost of flour. In many cases this small decrease in the cost of bread will not be passed on to the consumer in the form of a price reduction, but will be used, rather, for sales promotion so that an increased quantity will be consumed at the same price—a real change in the demand situation. Not only bread, but cake, pastry and other flour products will be urged onto the consumer. Partly because of this intensive selling and partly because consumers are accustomed to pay certain fixed prices, the retail price of bread may not change at all.

A large increase in the supply of a raw material generally will be accompanied by a fall in price. If the increase in supply is somewhat permanent, the lower price will usually be passed on through the industrial and wholesale markets to the consumers. If on the other hand, the increase in supply is only temporary, the lower price of raw material will probably benefit only processors and wholesalers. If the chain of distribution consists of many "links," the lag and friction prevent simultaneous price movements in the three markets. Prices of raw materials respond fairly quickly to any given change in supply and demand conditions, for buying in the producer or industrial market is usually on a large scale and by dealers who are familiar with market conditions. Unless changes which affect that latter market are expected to persist, they are likely not to be directly passed on to the wholesale and consumer market, both because of lack of knowledge concerning the changed conditions and because of consumers' willingness to continue to pay customary prices.

(2) The change in the supply-demand relationship for many other commodities, including manufactured articles with a comparatively low cost of raw materials, may make itself first felt in the consumer market as a result of a change in consumer demand. A small increase in the consumer demand for an article may not immediately result in an increase in the retail price, however, because prices have become fixed by custom and the consumers object to frequent changes. An increased demand will, therefore, merely mean a small increase in the quantity sold by each store. Since the individual item is generally but a small part of the retailer's entire sales, the increase may not be conspicuous. Increased purchases by retailers from wholesalers will have a cumulative effect, however, causing a depletion of wholesale stocks. This effect will be even more evidenced when wholesalers reorder from manufacturers, because their individual orders are larger and also because they constitute the main part of the manufacturers' total business. This increased pressure will result in an increased price in the producer market which will be passed on, in diluted form, to the wholesale and retail market, in the same manner as explained above in the case of wheat.

Conversely, a small decrease in demand for goods at retail is barely noticeable by each individual retailer. If the decrease is universal, however, wholesalers are unable to make their customary sales. They cease buying from the producers, often for a considerable period of time. Since buying of raw materials thus is less urgent, producers are forced to accept a lower price for their product, particularly if the supply is not readily adjustable to the new conditions.

There is, therefore, a marked difference in the behavior of prices in these three markets. Retail prices usually change only when a marked change occurs in wholesale prices, partly because of the small unit of sale, and partly because of the difficulty of changing consumer habits. A very small increase in wholesale price causes little or no change in retail price, unless the profit margin is seriously threatened, in which case the retailers increase prices. Although the retail prices thus seem to *follow* wholesale prices, they may often be said to *lead,* since the retail market first reflects the changes necessitating higher wholesale prices.

Market Price Versus "Normal" Price.—A distinction is commonly made in economics between market price and "normal" price. The former refers to the price actually paid in a market. At any one time or place, this price may yield the producer and distributor a high profit, or it may result in a loss over a long period of time. However, it is recognized that the price must be high enough to cover all necessary outlays for production and distribution, and yield some profit. When a price just accomplishes this end, it is usually referred to as a "normal" price, the price toward which the market price tends in the long run.

As far as the present course is concerned, we are interested in the market price of various goods. It is the daily price—be it high or low—which governs largely the distribution of commodities from day to day and from period to period. In the meantime we rely on competition to fix prices at about the level called for by long-run conditions. Some practical price problems are taken up in Chapter 11.

CHAPTER 11

PRICE POLICIES

It was suggested at the close of the preceding chapter that "market price" and "normal price" might be quite different at any one moment of time. Some of the things which make them different and something of the limits of such differences are discussed in the present chapter under the heading of price policies. As has been pointed out, there is no one market price for a given commodity even at a given time and place. This may be illustrated in the retail market by the fact that two stores within the same block will offer branded and identical commodities at widely different prices; cases may easily be found in which items sold for $1.00 in one store are priced at $.70 or less in the others. Similarly, in the industrial markets where sales result from individual bids, one selling firm may make a low bid on the material for one job and a much higher bid for another similar job on the same day. Some of the many considerations which influence the dealer in his price policy are here discussed.

Differences between Central Markets as to Methods of Price Determination.—The responsibility for determining the price at which goods shall be offered at any certain time is differently shared in different types of central markets. There are many variations in this matter, but the following are the principal methods used.

1. Prices may be set by *competitive bidding of buyers and sellers,* each having about equal bargaining advantage. For example, in the organized exchanges, bargaining continues until a single price establishes a definite equation of supply and

demand. All sales at that moment are then made at the established price. If the price seems either too high or too low to some traders, they offer to buy or to sell sufficient quantities to force the price into line. Such markets may be called *competitive-price markets.*

2. *Established-price* markets are the other general class of markets on the basis of methods of price determination. Such markets again fall into three general classes.

(a) Price established by bargaining between groups of sellers and groups of buyers. In such cases, prices are usually established for a definite period of time, one or more months, or in cases even longer. For example, in many large cities representatives of producers and distributors of milk meet periodically for the purpose of establishing the price of milk for the ensuing period, three months or whatever the period agreed upon.

(b) Price established by sellers. Prices of many industrial products, such as oil, steel, and others, are commonly said to be so determined. Among farm products, raisins and cranberries are cases where a sellers' organization sets the price at the beginning of the selling season, with reference to probable demand, so that the price set is designed to clear the market by the end of the season.

(c) Price established by buyers. The best example of such a market is that for sugar beets. The buyers of beets usually determine in advance of planting what price they are willing to pay for the season's crop, and a contract to that effect is entered into with producers of beets. Canners, likewise, frequently contract for produce at a price set by the buyer prior to harvest.

Two Major Determinants of Price.—To the business man there are two general methods of determining price, namely, (1) in keeping with the cost of production, and (2) in keeping with "what the traffic will bear." The first of these emphasizes the supply side, and the second the demand side, of economic production.

1. Prices cannot depart far from the cost of production for any considerable period of time. Generally, if they rise high above costs the profit will be so high that business men will flock to that branch of activity and by their increased production will tend to force prices down to normal levels, i.e., to levels approximating the cost of production. Similarly, if prices fall below the cost of production, men will lose money and will drop out of that branch of business until the scarcity of products causes prices to rise to the "normal" level, i.e., the level approximating the cost of production.

The cost of production varies widely between different competing firms, however. The market price will generally be set at approximately the cost to those firms which just find it worthwhile to stay in business, as indicated in the following diagram.

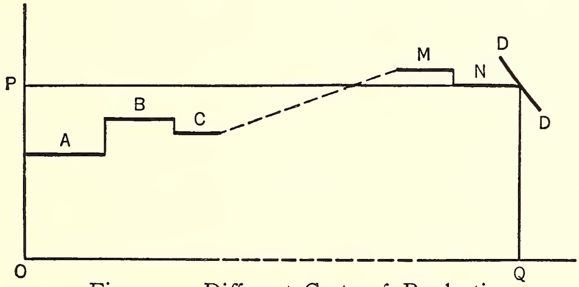

Figure 11. Different Costs of Production

In the diagram, the horizontal lines *A, B, C, N, M,* represent the average money costs per unit of production for the individual firms respectively. *D D* represents the demand schedule. If the price is established at *O P,* then the quantity taken—realized demand—will normally be *O Q*. In such a case, producer *M* could not remain in business permanently unless prices rose or he could lower his costs.

The situation shown in the graph is objectively illustrated in the production of coal. Some mines, by virtue of easy transportation, nearness of the coal to the surface, efficient management of labor and use of modern machinery, are able to produce coal very cheaply. Other mines, because of obsolete machinery, inefficient management, flooding by water, and other difficulties, have much higher costs. But the demand for coal is sufficiently great so that the price for the total production is sufficient to keep many of the high-cost mines in operation. If it were not that high, and these mines closed down, the industries of the country would probably be hampered by a lack of fuel. The price must be high enough, therefore, to keep the high-cost mines operating.

As another example, the situation shown in the graph was objectively illustrated during the late World War with respect to shoe prices. When this country entered the war, the government had need of several million pairs of shoes, and called for bids from various plants. Some shoe factories, by virtue of efficient management, modern machinery, and so on, were able to produce shoes very cheaply and sent in a consequent low bid for manufacturing army shoes. Other factories, because of obsolete machinery, inefficient management, and other difficulties, had much higher production costs and sent in a much higher bid than the low-cost companies. Since the latter could not produce enough to satisfy the government demand, the price finally set was high enough to enable some of the highest cost factories to fill part of the government's need.

It follows, then, that in framing a price policy, buyers as well as sellers must insist that prices be high enough to induce adequate production. In other words, prices must cover the costs of enough producers so that the industrial and consumer needs will be fully supplied.

2. Price in accordance with "what the traffic will bear" becomes a possible price policy under two sets of circumstances. In the first place, producers *A, B,* and *C* in our previous diagram—or the low-cost coal or shoe producers—may charge the

going market price for their products without much regard to their individual costs. Such a price may yield them a handsome profit. Their price policy is not determined by their average costs, but rather by what consumers will pay for the output of all producers. In that sense, their price policy is determined by "what the traffic will bear."

Whenever there is a monopoly of supply it is possible to charge "what the traffic will bear." Care must be taken even in such cases, however, not to set too high a price for fear of "killing the goose that lays the golden eggs." Extremely high monopoly prices tend to break the value of the monopoly, either (1) by attracting new producers into the field, (2) by inducing consumers to accept substitutes, or (3) by calling forth governmental interference. In general, producers who have a monopoly control of supply have the option of charging a high price for a small quantity of sales, or a lower price for a larger quantity of sales, for even with respect to monopolized goods there is a demand schedule which may be tapped at various points.

Railroads generally have a partial monopoly of the freight hauling in their territory, which monopoly is maintainable because of the extremely high cost of developing competing lines. Before the institution of the Interstate Commerce Commission, freight rates were generally set on the bases of "what the traffic would bear." But the railroads, in their pricing policy, were careful to add the clause, "and develop a profitable volume of business." In other words, they constantly attempted to arrange their freight rates so that their business as a whole would yield the greatest possible profit. Of course, they were not always successful in this effort, for human judgment is not infallible.[1]

The case of the railroads is but illustrative of industries with monopolized, or partially monopolized, control of supply.

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[1] Since the Interstate Commerce Commission has exercised its power of regulating freight rates, the effort has been to readjust individual rates on the basis of cost.

With all such industries, the price policy must be such that price will not fall below cost for any considerable period of time; that is, cost sets the lower limit of price. Nor can price for long rise above "what the traffic will bear and develop a profitable volume of business"; that is, demand sets the upper limit of price. Between these two limits, the price-determining monopolist attempts to find that price per unit which will yield the largest total net profit; that is, the point at which the profit per unit multiplied by the number of units sold is at a maximum.

Variations from a General Principle of the Market.—It has been stated that the quantity of any commodity demanded at a moment of time varies inversely with price—that is, the higher the price, the smaller the amount which buyers stand ready to take, and vice versa. This is not, however, an invariable rule and the exceptions to it are of importance in deciding what price is likely to prevail in the market, or what price a seller should ask in order to get the greatest total profit. The following are among the outstanding circumstances which lead to a departure from the general rule.

1. A rising price may result in increased purchases if there is danger of still higher prices. Manufacturers will often buy larger quantities of raw materials when prices are rising than they would in a stationary-price market, in order to avoid paying a still higher price three to six months later. If the price of household coal, or other non-perishable articles, rises and there is expectation of further advance, consumers will lay in larger supplies than usual. Such temporary increases in demand tend to intensify the scarcity and to cause the price to rise still further and faster. The time and rate at which the individual seller should raise his prices in keeping with a general price movement is frequently a critical matter of price policy.

2. Retailers often find that consumers refuse to buy low-

priced goods for fear that low price denotes poor quality. In the majority of cases, consumers have no exact or technical measurements of quality, so they must accept the word of the manufacturer or merchant. Since price is the most common measure of value, the consumer comes to depend upon it as his buying guide. Therefore, when consumers find an article priced considerably below what they are accustomed to pay, they suspect that something is wrong with the quality of the article.

3. In line with the point just made, it is often found easier to get acceptance for a new commodity at a fairly high price than at a lower one. Many instances are on record: a new breakfast food which failed to sell well at 8 cents a package was a great success at 14 cents; neckties which will not move at $1.00, may sell rapidly at $1.75; and so on. Such a situation is not likely to occur, of course, when trade-marks become established as symbols of standardized quality so that consumers generally may know relative values.

4. A sharp slump in prices may cause all buying to cease in anticipation of still lower prices. In such cases there is a glut in the market and virtually no buying takes place. Moreover, supplies are likely to be offered with unusual briskness and insistence, in the hope that they may be sold before prices fall still further. Such a situation frequently occurs in the livestock markets, for instance, as well as in the produce markets. The question of the time and severity of individual price reductions during periods of generally falling prices requires the best of judgment based upon a knowledge of the probable reaction of the particular clientele.

5. Increased demand may temporarily increase price, in accordance with the general principle, but later lead to a decrease below the original price. This result occurs when large-scale production follows the increased demand, provided that the large-scale production lowers the production costs. It follows

as a corollary that it may be good policy to quote prices below present costs if by so doing sufficient additional patronage is attracted to reduce unit costs by an amount greater than the reduction in price.

These exceptions to the general principle of price movements are usually temporary. In part, each of them is predictable. To the extent that they are predictable, they should be considered in determining the price which will be offered or asked.

Basic Pricing Systems in Vogue.—The price for similar units of an article of uniform quality at any one time in a single market is popularly supposed to be uniform. In the case of primary materials, at least, this tends to be the fact, for economy of purchase is so strong a buying motive that purchasers see to it that they pay no more than their competitors.[2] As already pointed out, the commodity exchanges tend to bring about that uniformity of price for such commodities as cotton and grain.

Similarly, staple fabricating materials—which are sold in established-price markets—tend toward uniformity in prices. Each producer of such articles ordinarily must sell his product at the competitive price. The Pittsburgh basing-point system of pricing steel products, which was in vogue until recently outlawed by the Federal Trade Commission, illustrates this tendency. Under this system, steel manufacturers, wherever located, quoted prices on a Pittsburgh base, to which they added transportation charges from Pittsburgh to the point of delivery. Thus all prices quoted in a given market tended to be equal, regardless of the fact that some manufacturers were much closer to the market than were others.

The economic explanation of an original justification for this pricing policy is simple. Steel plants are expensive to build and therefore competition grows slowly. For many years Pittsburgh was the largest steel producing center in the United

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[2] Quantity discounts may sometimes be considered a departure from this stated condition.

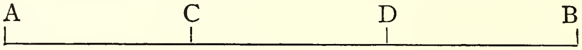
States, and Pittsburgh steel products were sold in all other markets. As the requirements for steel in Chicago increased, for example, plants were gradually developed there, but for many years these plants were unable to supply the needs of the Chicago market. Consequently, Pittsburgh products continued to enter that market. Because the Pittsburgh plants were less efficient than the newer ones in Chicago, and because of the transportation costs of getting steel from Pittsburgh to Chicago, the Pittsburgh plants became the high-cost producers for the Chicago market. Consequently, the Chicago price became that of Pittsburgh, plus transportation charges, just as the costs of the low-grade mines become the price of coal, or the cost of *N* becomes the price of *O Q* product in the generalized diagram on page 159. Since this was the case with steel, the habit grew up in the trade of quoting prices at whatsoever point as "Pittsburgh plus."

This practice continued so long as Chicago plants were unable to supply the local requirements; but when their plants produced enough so that they entered actively into the competition in Pittsburgh and other eastern markets, Pittsburgh products were no longer needed in Chicago. To refer again to our diagram producers *A, B,* and *C* had so expanded their low-cost production that *N* was no longer properly a factor in their market; hence the Federal Trade Commission quite rightly condemned the system of pricing as obsolete. Steel prices are now quoted delivered where ordered, without reference to the Pittsburgh base.

The pricing system used in the Portland cement industry is somewhat different and leads to a different sort of uniform price. In this industry the price is determined in one of two ways, the lower of the two being quoted in each case: first, the manufacturer's price at his mill, plus the freight charge from the mill to the purchaser's town; or second, some other manufacturer's price at his mill, plus the freight charge from his mill to the purchaser's town.

The diagram may illustrate these methods more clearly:

Pricing Method in the Cement Industry



If two mills are located at *A* and *B* respectively, the price of cement at *C* will be the price at *A* plus the freight from *A* to *C*, while at *D* it will be the price at *B* plus the freight from *B* to *D*. If *A* enters the *D* market, as he is likely to do, he quotes *B*'s price plus the freight from *B* to *D*. This means that he gets a smaller "mill net," i.e., the price actually retained by the shipper after paying the freight, for his product sold in *D*, than for that portion sold in *C*, because he actually pays the railroad a higher freight rate than he charges the buyer.

In the cases of flour, automobiles, and many other commodities, on the other hand, prices are quoted f.o.b., and the full freight charge from the point of origin to destination is paid by the buyer, regardless of his location. This means that the seller gets the same net price no matter where his shipments go.

One of the principal points of importance in these different price policies is their effect on widening the market area of the individual producer. When well-known goods are of the same quality, they tend to sell for the same price in a single market. Portland cement is much the same, regardless of where or by whom it is manufactured. Manufacturer *A* can only enter manufacturer *B*'s natural trade territory, then, by meeting *B*'s price and he can only do this by paying part of the freight himself. In the cases of flour and automobiles, on the other hand, the producer has some opportunity to convince the consumer that his product is enough better than his competitors' to justify a price differential equal to the difference in freight. Really, of course, the matter is not quite fairly tested in the case of automobiles, for the points from which freight is charged are so localized that the consumer pays about the same freight in addition to the f.o.b. price, no matter what car he buys. It would be interesting to know whether the automobile industry would adopt the cement industry's system of pricing if it were equally decentralized.

Systems of Pricing at Retail.—In the market for consumer goods generally, commodities are not so completely standardized as are the primary materials. Each manufacturer claims peculiar qualities for his particular goods, which the consumer is rarely able either to verify or to dispute. Consequently, each particular brand or offering tends to carry its own price.

A business man in the market looks around him and observes that the "going price," the prevailing price, for his line of goods is at a certain level. He may then decide upon either of three different price policies, namely:

1. He may name a price slightly below the market level.
2. He may offer his goods at the going market price.
3. He may price them above the market level.

Both manufacturers and retailers have been successful with each of these policies. Macy's department store in New York City is a remarkable example of success resulting from adherence to the first policy (a guaranty that prices are lower than anywhere else in the city). Bamberger's of Newark is an equally outstanding example of successful pricing above the market, in exchange for which they claim to give the finest customer service in the world. Johnson-Murphy and Douglas shoes, Hickey-Freeman and Foreman-Clark suits, Pierce-Arrow and Ford Motor cars, are illustrations, respectively, of the slogans "Costs more, but worth it," and "Cheaper, but why pay more?"

Pricing above the market level will draw the smaller, more particular clientele—those who can afford to choose. Pricing at, or below, the market will reach the masses. Pricing above the market can be a permanent price policy only when the product or the service really gives additional satisfaction. Each manufacturer and each merchant must determine his price policy, then, in accordance with two factors, namely, the lasting quality of his offering, and the clientele to which he intends to appeal.

There are other influences which help determine the pricing policy of the individual merchant. For example, it is common practice for retail stores and other mercantile establishments to add a *normal* or *average mark-up percentage* to the cost of goods. This percentage is based upon the measured or anticipated costs of operating the enterprise and is designed to permit the business to show a reasonable profit. There are numerous instances, however, in which mark-ups are varied from these averages in order to sell at *customary* or *convenient* prices. Coca-Cola, Wrigley's chewing gum, Campbell's soup, and many other articles have been selling at the same price for years despite business cycles and fluctuations in their costs of production. Another departure from average mark-ups is the practice of naming *odd* prices; this means that "change" must generally be made. It is the belief of those using such a pricing system that the odd figures suggest the idea of a bargain; it has even been found by test that often the sales of an article will be greater at 17 cents than at 14 cents, because the former suggests a reduction from 20 cents while 14 cents seems only to have been reduced from 15 cents. Moreover, while the customer is waiting for his change he may find something else to buy.

Resale Price Maintenance.—Manufacturers of branded goods often want to determine the price at which their goods shall be sold to consumers. This desire arises in part because they then can name either a high price or a low one and thus partially determine the class of their clientele; if prices are cut, the article may lose prestige. A further and probably stronger reason is their wish to prevent the extreme price-cutting which undermines distribution channels.

The way in which price-cutting sometimes injures distribution may be illustrated as follows. A dealer in a town of 10,000 population, where most of the stores are on one short Main Street, offers a dollar article for 69 cents. This price is approximately what he has paid for the article; it leaves him no profit, but as a "leader" it attracts people into his store. Nearly all the people in town will buy the article there, if they buy it at all. As a result, the other dealers make no sales and refuse to carry the article any longer, but put in competing brands instead. Finally, when nearly every one who wants the article has purchased it, sales fall off, and it is no longer useful as a leader. Then the price-cutting dealer, not wanting to raise the price, fails to restock this item, and he also puts in a competing brand, so that the manufacurer has no distribution in the town at all. This is the chief complaint of the manufacturer against price-cutting.

National advertisers who distribute their goods through dealers and jobbers are almost a unit in favoring price maintenance. As a result, a bill to legalize resale price maintenance on branded goods was introduced in Congress in 1926 and has been under consideration constantly since that time. The Federal Trade Commission was instructed to make a thorough investigation of the arguments pro and con. The results of this investigation have been published, but no definite action has yet been taken.

Manufacturers claim, in support of this measure, that they have a bona fide interest in their goods even when physical ownership has passed to the merchant. They claim, in essence, that they own the goodwill which attaches to the brand, and that, while the merchant may do what he will to the physical good, he must do nothing to injure the goodwill.

For example, when a dealer buys a case of plain, unbranded soap he assumes the entire burden of finding a market and of guaranteeing the quality. But when he buys a case of Ivory or Palmolive soap he gets soap plus a market already created and a confidence in quality which requires no further guaranty. Those attributes are inextricable parts of his purchase, and the manufacturer claims the right to prevent the use of a price policy which will destroy those attributes.

It is possible that some cases of injury to goodwill have resulted from extreme price cutting, although this would be difficult either to prove or to disprove. Certainly the sale of some branded goods has been greatly stimulated through consistent price reductions. Moreover, from the merchant's point of view, it seems clear that price reductions which are made possible by efficient store management are legitimate tools of competition. Merchandising costs generally are as great as manufacturing costs; the variation in cost between individual stores are large; in the interests of competition and the development of efficiency in store management, it is essential that the merchant be free to pass on his savings to consumers in the form of price reductions. As he does this he attracts more patronage and forces the high-cost merchant either to retire from the field or to improve his methods.

While the manufacturers, the consumers, and the other merchants may all be justified in objecting to a cut-throat price policy, it is difficult to find valid economic objections to price concessions which result from efficient merchandising.

CHAPTER 12

MARKET RISK

Risk Defined.—Risk has been defined as uncertainty in regard to cost, loss or damage.[1] In our present social and economic development, risk is an all-pervasive element. Uncertainty appears on all sides—uncertainty as to the weather, uncertainty as to the prompt arrival of shipments, uncertainty as to the plans of competitors, uncertainty as to response of customers, and uncertainty concerning changes in price which may accompany either economic or psychological development.

Fortunately, however, not all risks or uncertainties are important. Only those cases where the interest dependent upon the outcome of a single uncertainty is large, relative to the entire undertaking, need influence business decisions. For example, the risk of loss through burglary may be large in the case of a diamond store, while a similar risk is remote—although possible—in the case of a brick yard. Practically, risk is not present in all our calculations.

Risks are frequently necessary and inescapable incidents in business undertakings. For example, when a perishable commodity, such as lettuce, has been produced there is the risk that it will spoil or that it will be shipped to the wrong market. These risks exist and must be met by some one connected with the marketing process; whoever carries them performs one of the necessary marketing functions.

In other cases, however, risks may be created or increased merely for the excitement or chance of gain which they afford. When men bet that one of two football teams will win a certain game, the uncertainty as to who will win the wager is in no sense essential to the playing of the game; therefore, no necessary function is performed.

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[1] See C. O. Hardy, *Risk and Risk Bearing.*

In marketing, *speculation* is concerned with the first type of risk illustrated—that which is inherent in business. Artificial, or created risks, on the other hand, involve *gambling* rather than speculation. In the latter cases, risk is increased for the sake of the risk; the only possible social gain is the direct utility of the excitement. Business decisions, as that term is here used, are concerned only with speculative risks.

While uncertainty is a major and ever-present cause of risk, it is not the sole cause. Risk arises, also, out of the inability of individuals and institutions to adjust themselves instantaneously to unexpected changes. It follows, therefore, that the degree or intensity of risk depends in part upon the promptness with which adjustments can be made after unpredicted changes have occurred. The change in men's collars from the stiff to the soft styles was unpredicted and, therefore, the losses incurred by manufacturers were the result of risk. A considerable part of the loss was the direct result, however, of the necessity for new equipment in the collar factories. It is the fixity of investment in plant which often makes an unpredicted change a serious matter.

The Practical Importance of Risk.—The practical problem connected with risk is the discovery of methods by which it may be reduced, eliminated, or avoided. Business profits are, in a large measure, rewards for carrying necessary risks, or for escaping risk through more adequate planning and management. The risks with which profits are associated must not be confused, however, with the regularly recurring, calculable losses of a business. Such losses simply increase the outlay for labor and capital goods, while uncertainty cannot be provided for in advance by similar expenditures. For example, compare the breakage of bottles in the brewery business of a few years ago with the chance that temperance legislation would destroy the industry. The former merely required greater outlay in the purchase of new bottles. The latter was a not-to-be-compensated loss. To induce men to assume the risk of such a loss, they must be paid something—not necessarily enough to cover the loss if it should materialize, but enough to make them willing to face the possibility of loss.[2]

Causes of Uncertainty.—The basic causes of uncertainty are of importance because they suggest methods by which risks may be reduced, or methods by which business may be adjusted to the risks. For convenience, these basic causes may be grouped into five classes, as follows:

1. Physical hazards of nature.
2. Physical hazards in industry.
3. Social hazards from individual conduct.
4. Social hazards from individual ignorance.
5. Market risks that come with the lapse of time.

1. The physical hazards of nature include such destructive agents as storm and fire. Weather reports have already done a great deal to lessen the uncertainties connected with changes in weather, but as yet we have no accurate forecasts which extend over 48 hours in advance. Much has also been done to reduce the fire hazard, such as constructing buildings of fireproof materials, installing sprinkler systems, and so on; but a considerable element of uncertainty still remains.

2. The second source of uncertainty—physical hazards of industry—may concern the marketing process whenever imperfections and inequalities in goods arise unknown to dealers in advance. Departure from specification or representation calls for adjustment by the marketing agency. This sort of risk is, however, of more general importance in manufacturing than in marketing.

3. Business relations are built up on the expectation that people will conform to certain general laws or norms. These laws may be legal and enforceable statements, or they may

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[2] F. M. Taylor, *Principles of Economics*, p. 495.

be merely customary behavior. In either case, deviations of individual conduct from these norms, such as robbery, forgery, riots, or even the wearing of extreme styles, cause risks which are present throughout all business, marketing included.

4. All uncertainty is due to ignorance, in the broadest sense, for if all the conditions of any situation were fully known by everyone there would be no risk involved. Actually, there is a lack of *complete* information about each situation, and this gives rise to risk. More important, however, is the fact that some individuals have more complete information than do others. It is this difference which makes it possible for people of superior knowledge and judgment to succeed where others fail. Ignorance of existing opportunities keeps people from entering a certain field, while ignorance of methods of operation keeps some who have entered from succeeding. This source of risk is illustrated in marketing by the differences in accuracy of information concerning goods in storage, shipments of competitors, and so on, as between individual buyers and sellers.

5. Perhaps the most important risks from the standpoint of marketing are those due to the elapsing of time between the purchase and sale of commodities. Rarely is it possible to purchase and resell a commodity simultaneously. Often a dealer—a wholesaler, for instance—will buy a commodity and store it for months before reselling. In fact, there is usually a long elapsed time between the start of manufacturing and the final consumption for practically all commodities; one of the features of modern business is its "roundaboutness."

At least four sorts of things *may occur to an uncertain extent* during this roundabout process, thus giving rise to risk. (1) The commodity in question may physically deteriorate—spoil—to a greater or less extent than anticipated. (2) There may be an unexpected change in demand due to change in style or consumption habits. This will affect the price which will be paid for the article, relative to other commodities. (3) A change may occur in the general price situation—in the basic relationship between goods and money—so that the money promised or received in exchange for goods will purchase more or less than originally anticipated. (4) Producers may change their plans, or weather conditions may change during the growing period for crops, so that the amount of the commodity which is offered for sale is materially different from that anticipated. Whoever holds title to the products during this interval of time bears the risk.

Market Risks Greater Than Those of Physical Production.—Market risks are usually greater than the risks of physical production. This is due to two general causes. In the first place, marketing has been given less scientific study than has production, with the result that there is less organized knowledge regarding it. In the second place, marketing depends in many respects upon the reactions of human beings—their likes and dislikes, to which they are allowed free expression. Most consumers do not operate on a budget as do most manufacturing establishments; hence, there is much uncertainty as to the ways in which they will spend their income. New fads and styles upset the old processes, bringing loss to old and temporary gain to new producers. The behavior of people under given circumstances is neither so well understood, nor so constant, as the behavior of the inert materials with which physical production is generally concerned.

Illustration of Market Risk with the Lapse of Time.—Market risks are generally the result of imperfect market information. Business men cannot know the future conditions of supply and demand accurately if they operate in ignorance of each others' actions—which they generally do. An illustration of incomplete market information is found in the marketing of livestock, where it appears to lead to serious waste.

"Perhaps the greatest weakness in the present situation in livestock marketing is that marketing takes place in almost complete ignorance of the supplies to be marketed. None of the agents of the industry, such as producers, railroads, market agencies, or slaughterers, have any adequate knowledge of supplies to come either in the immediate or more distant future. The only guide to probable numbers is the amount of the immediately past receipts and those during similar periods in other years. Admittedly, the securing of such information in an industry of such magnitude, drawing its supplies from so widely extended and dissimilar sources, would be most difficult, but in the lack of such information the whole industry works more or less in the dark, and long-view plans of handling either animals or their products cannot be made. The risk element is thus made larger but, unfortunately for the producer, the other interests either do not share in this risk, or they are able to shift it back upon him. If the production is too large, or is poorly distributed, and prices decline, the effects of this decline are borne almost entirely by the producer, for his profits, alone, depend primarily upon the price of livestock.

"A second grave fault of present methods of distribution is that no organized attempt is made to accommodate supplies of livestock to consumptive demand for meats. Animals are sent to market, are slaughtered, the products are pushed into consumptive channels, and consumption is forced to follow slaughter, especially with the perishable products that make up a large part of the whole.

"The controlling element in all the associated activities is the loading at country points and the resulting arrival of stock at the market. The railroads, stockyard companies, selling agencies, and slaughterers must carry on their operations according to this volume, and as this is a changing one, both as to days of the week, weeks of the month, and months of the season, each must be equipped to handle a peak of supplies for these different periods, which results in a labor and overhead cost unnecessarily high. To the extent that these variations in livestock supplies cannot be smoothed out in distributing the products, the prices of these latter must fluctuate to bring about a (realized) demand that will absorb the total, with a resulting unstable price range.

"A third defect is that there is no method by which temporarily excessive receipts can be checked by concerted efforts of shippers, but that this can only be brought about by price reductions. These occasionally excessive receipts are due, in part, to conditions developing in regions that contribute large supplies to seasonable movements, but in great part they are due also to chance, in that too many shippers decide to ship on a given day or in a given week.

"Again, daily distribution within the week is very faulty and makes efficient handling difficult. The tendency to make use of Sunday to move stock to market, and the prevalence of Saturday as a marketing day, result in too large a proportion of the supply coming at the beginning of the week. This is especially true of stock shipped and accompanied by individual producers, and to a considerable extent with that shipped through shipping associations that have set marketing days. The worst offenders in this respect are cattle shippers. In 1919, 57.5% of the total weekly receipts of cattle for ten markets came on Mondays and Tuesdays." [3]

Reduction of Risks.—Methods by which risks may be reduced may be analyzed in definite classes. The elimination of risk requires the elimination of the *uncertainty* regarding the time, place or extent of loss or damage. The loss or damage itself may still occur, but may become a definite, predictable item of cost, rather than an uncertain one. In the administration of business, risk may be reduced in any of the following ways:

1. Prevention of harmful events.
2. Forecasting or research to remove the uncertainty.

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[3] R. A. Clemen, *American Livestock and Meat Industry*, pp. 607–608.

3. Combination of risks.
4. Accumulation of reserves.
5. "Compensation," or offsetting risks.

1. Prevention of harmful events is practiced in marketing whenever more careful methods of handling are introduced. Care in packaging commodities, use of cold storage and refrigerator cars, more rapid turnover of goods, are methods of preventing physical deterioration. An illustration of a different sort is found in those cases where advertising or other forms of demand manipulation are used to retard changes in fashion. For example, at one time the fashion in men's linen collars was what was known as a straight, or standing, collar. About 1905, men all over the country began to demand turn-down collars. The turn-down collar was more expensive to manufacture and required the installation of new machinery. For a period of several years, therefore, collar manufacturers used every known means of sales promotion to induce men to continue the use of the old type collar. To the degree that they were successful, they lessened the abruptness of the change and reduced the sudden uncertainty to a predictable cost.[4]

2. Research, forecasting, and budgeting are coming to be universally practised in the reducing of ignorance. The complexity and variation in the methods used are so important in the planning of marketing that the entire next chapter is devoted to them.

3. Elimination of risk by combination is the application of the so-called law of large numbers. The commonest form in which the principle of combination is applied to the reduction of uncertainty in business is that of insurance. If a man owns only one store building there is great uncertainty as to whether—or when—it may burn down. If, on the other hand, several thousand buildings scattered over a wide area are considered together, experience makes it possible to predict with some precision how many will burn down each year. If dif-

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[4] P. H. Nystrom, *Economics of Fashion*, p. 15.

ferent people own these buildings they may each pay a fixed amount into a common fund with which to reimburse the loss to the owners of those buildings that are actually destroyed. In this way, while no change is made in the actual loss or destruction by fire, nevertheless the element of uncertainty is greatly reduced by each owner paying a definite, annual sum into the common fund. It is sometimes said that by this process the risk is shifted to the insurance company. Actually, however, the risk is borne, as a cost, jointly by all the owners. The larger the number of cases combined the less will be the deviation of results from predictions, that is, the less the uncertainty.

Insurance is commonly used by marketing agencies against the uncertainty of physical loss while goods are in transit or in storage. Thus, wheat is insured in the local elevator, in the terminal elevator, in the mill's elevator, and in transit if exported. Also, mail-order houses frequently insure valuable articles which they send to consumers.

The law of large numbers operates also to permit department stores and other shopping institutions to carry the wide variety of articles for which they are noted. Tastes vary and, therefore, if the clientele is large enough, almost any sort of commodity may be sold.

4. Every well-organized business sets aside part of its resources to have them in readiness for situations which may arise quite unexpectedly. To an individual plant, the loss of production which results from the idleness of these reserves is part of the cost of uncertainty. Every activity by which uncertainty is lessened reduces the necessity for reserves. Thus insurance, better forecasting of demand, prevention of storage losses, and so on, all reduce the amount of contingent reserve which it is expedient to withhold from direct production.

5. Compensation of risks refers to the adjustment of business so that losses on one transaction will be offset by gains on another. Hedging contracts, which are described in detail

in Chapter 14, are the most common form of compensating risks in marketing. Planting a dry-weather and a wet-weather crop in the same year is an illustration from agriculture. In manufacturing, producing two items having different seasonal demands is based upon the same principle.

The first two of these five methods of reducing risk—prevention and forecasting—may be termed *direct* methods, that is, they actually lessen the loss or damage, as well as reduce the uncertainty to the individual operator. The other three methods accomplish only the latter. The distinction between the direct and indirect methods may be illustrated by the case of insurance. Insuring against risks which are possible of direct reduction frequently leads to carelessness in preventing them and occasionally even to intentional losses. Insurance companies generally recognize this danger; they attempt to educate their policyholders in the prevention of losses, give reductions in premiums for the use of safeguards, and sometimes exact penalties for negligence.

Whether the use of one of the direct methods is expedient in any particular case can be determined only by a balancing of the cost of the prevention or the forecast against the loss which might otherwise result from the uncertainty.

Specialization in Risk Bearing.—In spite of the universality of risk, the modern organization of business has provided a high degree of specialization in risk bearing. For example, the laborer's share in the value of any commodity which he has helped to produce is generally a contractual wage, the amount of which is determined in advance. The capitalist—the one who furnishes the money with which an enterprise operates—frequently receives a definite return. These two factors in the cooperative production of society, therefore, often receive a stipulated return, which is largely independent of the outcome of the undertaking in which they are engaged. Thus, the majority of risks—especially those which pertain to marketing—must be accepted by the owner-manager.

The general organization of business permits owners to transfer certain types of risk to others. The method of insurance has already been cited; in this case the individual uncertainty is transferred to the group and is carried as a definite cost by each member of the group. In many lines, contracts specifying quantity, quality and price are entered into prior to production, thus reducing uncertainty. It is common practice, for instance, for grocers to contract for a supply of canned goods, for sugar refiners to contract for a supply of sugar beets at a stated price, for clothiers to contract for a supply of suits, and so on. Future trading and hedging are special marketing devices through which owners of physical goods may pass risks of price change to speculators.

There are also various formal guaranties which are given to relieve the buyer of risk. For example, goods may be sold with a guaranty of quality according to some specification or standard; some stores guarantee "satisfaction or your money back"; frequently, a manufacturer will agree at the time of sale to refund an amount equal to any price reductions which are granted other customers before a stated date. In spite of these methods of transfer and reduction of risk, however, much uncertainty still attaches to the ownership of any commodity.

The following two chapters are devoted to special methods of reducing risk. Chapter 13 deals with methods of business research and the types of forecasts which are undertaken to reduce uncertainty. Chapter 14 describes the commodity exchanges and the trading practices which are used there in the effort to reduce risk. In these two methods of reducing risks are to be found some of the most hopeful suggestions for future improvements in the efficiency of marketing institutions.

CHAPTER 13

MARKET RESEARCH

Purpose of Market Research.—Market research is an organized attempt to reduce market risk. Its principal task is to widen the basis of facts upon which business plans are laid. To the extent that market research is successful in providing more accurate information from which business judgments develop, the cost of marketing should be lowered. For it is one of the axioms of our present economy that the less the risk, the less the profit margin necessary to make men willing to face the possibility of loss.

Research or investigation is defined as "the process of inquiring or examining into with systematic attention to detail and relationship." This, then, is the purpose of research, wherever met with. It involves: (1) critical observation, accurate description, analysis, and classification of the facts bearing on a problem, and (2) development of a practical solution through the application of logical, unbiased reasoning to the facts which have been observed. This process is often spoken of as the "scientific method" because its earliest applications were in the physical and natural sciences. More recently, it is being used in solving many of the complex problems of industry and trade.

The Development of Scientific Management.—Fifty years ago Frederick W. Taylor, then a young employee of the Midvale Steel Company, began his now famous experiments in "scientific management." He undertook to apply the scientific method of study to the problems of production; that is, he arranged his experiments so as to hold all variables constant except the one under observation at the moment, and to control the variations of that factor. In this way he studied separately the effect on production of changes in the condition of shafting, belting, speed of machines, shape and temper of tools, rate of feeding materials into machines, composition and preparation of materials, methods and motions of the workers, and so on. With the aid of this method he was able to discover for each operation a standard combination of conditions which, when maintained during an operation, would permit increases in output amounting in some cases to several hundred per cent. These increases, while of importance to employers, were also of great importance to employees, because they were accompanied by actual diminution of the fatigue of the worker, for the same reason that a professional with correct skill and tools becomes less fatigued than an awkward amateur. The first requisite for the comparative judging of enterprises is a standard of measurement, and it was to provide such a set of standards that Taylor worked. The Taylor Society, named in his honor, is continuing to build up improved standards in the same painstaking, scientific manner.

One simple example will illustrate the accomplishments of scientific management. Thirty years ago it was common in industrial plants for beltings to give way in the middle of an operation. As a result, the machine was shut down and its operators became idle while the belt repair man was located and given time to make the repair. Today, instead of waiting for belts to break, records are available on which to base the probable length of life under each set of operating conditions in the plant. It is some one's job to replace each belt in turn shortly before it is likely to break, as indicated by the records. In this way, frequent shut-downs are prevented, output is maintained at a constant, predictable rate, and considerable financial saving results.

Scientific Management Applied to Marketing.—More recently, similar methods have been used in the study of marketing. The problems which have been studied divide into two groups, namely, (1) those concerned with the physical side of marketing, and (2) those connected directly with exchange, i.e., with supply and demand.

Studies in the elimination of waste effort—whether in packaging and repackaging, in cross-hauling either between areas or within the store, in unnecessary steps for clerks, or in poorly designed stockrooms—are being undertaken by the scientific technique. Decisions regarding the type and location of mechanical conveyors, the choice between central wrapping and individual-clerk wrapping, or the placement of the most frequently sold articles within reach of the clerk at the counter, are all direct results of research as to the relative efficiency of different methods. In many of these physical problems of marketing, the opportunity for controlled experimentation with objective measurement of results is about as complete as it is in manufacturing and other fields of primary production. The use of the method so far described is limited, however, to studies within an individual plant or store, under its own specific operating conditions. It sets up no general standards of comparison or measurement.

A different method of studying marketing problems is frequently used with groups of similar institutions, for with groups it is inconvenient or even impossible to hold constant all factors except the one under observation. In such cases, it is necessary to rely upon statistical methods of measurement and interpretation, and especially upon the so-called law of "averages" or of "large numbers." In this method a great many observations are made on the relationship between one variable and the efficiency of the enterprise, with either operating expenses or net profit as the measure of efficiency. For example, reports may be obtained from 1,000 grocery stores, giving the rate of stock-turn and the percentage of net profits. When these reports are classified according to the rate of stock-turn, it will probably be found that the low stock-turn group and the high stock-turn group have very different average net profits; and the rate of stock-turn which is associated *on the average* with the highest net profit may then be determined.

This method requires four steps, namely, (1) the collection of a large number of data, (2) the selection of those cases which are strictly comparable and pertinent to the problem in hand, (3) the classification of the selected data into statistical groups as determined by the magnitude of the variable under observation, and (4) the finding of the average performance for each group. The standards thus secured from studies of comparable institutions may be likened to par in golf, i.e., something quite possible to achieve, frequently surpassed by the successful, to be striven for by the novice.

Standards of marketing operations have been determined in a considerable number of cases through the use of this statistical technique. Studies have been made of the marketing of primary materials such as grain, cotton, coal, and iron, and of the wholesaling and retailing of manufactured goods. Thus, individual operators are enabled to compare their achievements with those of their group as an average.

Professor Secrist of the Northwestern Bureau of Business Research, in reporting the results of a study of standards in the retail clothing industry, summarized the importance of these two types of market research as follows:

"So far as my knowledge goes there is but one way by which retailers and others as a class may remove the uncertainties associated with competition, arrive at standards of operation against which they may judge and be guaranteed a reasonable profit. This involves, first, an analysis of mass information, in order to determine the underlying business facts and principles, and, second, merchandising in the light of these principles. The first requires group analysis; the second, a study of individual store methods. By 'mass information' is meant information of similar character, standardized in form, and growing out of the experiences of groups similarly situated and rendering similar services. Behind individual business operations, as reflected in individual accounts, there are master facts, common to an industry, trade or economic service. Analysis of group data will reveal them. They then become the norms or standards against which individual business operations may be measured, appraised, and their economic justification determined."

Some of the "master facts" which have been developed concerning the physical aspects of marketing are presented in the chapter on marketing costs. Individual variations from these standards, and the resulting profit or loss, are also there considered.

Study of Supply and Demand.—In the other phase of marketing, i.e., the measuring of the forces of supply and demand, data are inexact and incomplete at best. In these matters, market research belongs in the category of the less precise sciences in which much still remains uncertain and subject to human judgment. Nevertheless, even when facts about the market are scarce, the experience of those who have used what are available has been that market planning gains by their use. Moreover, market data are improving each year in exactness, in completeness, and in the skill with which they are being used. As time goes on, marketing experts may come to agree with Roy Chapman Andrews, the explorer, when he says that, "any adventure, any real surprise in an undertaking, is the result of incomplete planning."

As suggested in the chapter on market demand, two of the principal determinants of general business activity are income or purchasing power, on the one hand, and the attitude of people toward expending their incomes, on the other. People who have studied the movement of business have come to the conclusion, pretty generally, that there is some kind of order or sequence in the course of economic events, i.e., "coming events cast their shadows before them." To the extent that this sequence can be established, the general course of business, or the interplay of income and desire, can be foretold.

Business Forecasts. As a result of this belief, many experiments in forecasting have been made in recent years. In December, 1929, Professor Garfield V. Cox published a critical analysis of the results of the leading forecasting services.[1] He concludes that, since 1922 at least, the prediction of the major turns in business activity which occur every three or four years has left much to be desired in the way of accuracy. Only once in the ten years studied, however, were any of the forecasts actually misleading, namely, during the down swing in 1923. On the other hand, the monthly predictions generally have been satisfactory and extremely useful in the planning of production, purchases, and sales. In this particular, the better of the services are in error not oftener than one month in ten.

As a concrete result of their forecasting, the services are educating business leaders to study conditions more closely and to correct maladjustments before they become serious. This tendency is exemplified by the attempts of various groups, fostered by President Hoover, to prevent the stock market debacle of November, 1929, from seriously affecting industrial production.

Among the leading forecasting services in the United States are Babson's Statistical Organization, the Brookmire Economic Service, the Harvard Economic Society, Moody's Investors' Service, and the Standard Statistics Company. Other organizations, such as the Federal Reserve Board, the several Federal Reserve banks, and some private institutions, such as the National City Bank of New York and the Cleveland Trust Company, also publish many valuable current statistical data, but they do not formulate their forecasts in such definite terms.

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[1] G. V. Cox, *An Appraisal of American Business Forecasts,* University of Chicago Studies in Business Administration, Vol. 1, No. 2.

Foreign counterparts of these services have generally followed American forecasting methods. Their results are of especial value to any who are interested in international marketing. They include the monthly letter of the London and Cambridge Economic Service, Indices du Mouvement General des Affaires en France et en Divers Pays, Vierteljahrshefte zur Konjunkturforschung, and Indice del Movimento Economico Italiano.

INDIVIDUAL DEPARTURES FROM THE FORECASTS. These general forecasts leave much to be desired so far as individual industries are concerned. With agriculture, for instance, a single crop may be unusually large, or nearly a failure, due to unpredictable climatic changes. General business forecasts give no warning of such events, and often their occurrence is without effect on general business except in a very limited area. Moreover, some industries are closely related, while others are not. For example, a few years ago the price of sugar fell strikingly, relative to other prices. The California walnut growers saw their opportunity in this fall; cheap sugar meant large confectionery sales; walnuts are used in confectioneries; result, an automatically enlarged demand for walnuts, which justified a higher than usual price. The logic proved correct, and they were able to maintain a high price for their commodity relative to other prices. The low sugar price and the high walnut price complemented each other; neither was directly the result of general business conditions; the value of the general forecast in this case was the indication that sugar prices were relatively low—the information upon which the walnut price policy was based.

As another illustration, in 1921 general business fell off greatly, but this depression affected various retail outlets differently. Sales of mail-order houses decreased 30%, partly because the rural districts were so seriously affected by the drop in prices of farm products. In contrast, five and ten cent stores actually showed an increase in sales, partly because low incomes caused some people, who formerly patronized more pretentious stores, to buy hand-to-mouth in these establishments.

Such variations and interrelations are common. This fact has led many industries to undertake their own forecasts, often through trade associations. In 1924, the Pollak Foundation for Economic Research published a series of articles under the title, "The Problems of Business Forecasting." In this collection are included methods of forecasting railway traffic, automobile production, building construction, mineral output, corn and hog prices, and so on.

Moreover, individual institutions undertake their own specific forecasts. Chain store groups study the traffic and travel habits of people before opening new stores. The American Telephone and Telegraph Company is constantly studying population and business trends in order to plan its long-time installations of main lines. The packing industry governs its purchases of livestock by studies of consumers' markets for dressed meats.

Not only has each industry specific problems of market analysis, but so has each geographic area. Income variations in one district may not coincide with those of the country as a whole. It has been said, for example, that most industrial fluctuations start earlier and are more severe on the Atlantic than on the Pacific Coast. Geographic distribution of industries also causes differences to exist. It becomes essential, therefore, that local studies be made if local forecasting is to be accurate.

Local Measurements of Buying Power. There are now available several fairly accurate measurements of buying power by counties, which are being modified annually or whenever new income data are available. The publications of the Curtis Publishing Company, the Crowell Publishing Company, and the Dartnell Corporation are among the outstanding examples. Other agencies have undertaken to study trading centers, regardless of county or other political lines. The United States Department of Commerce study of wholesale grocery territories is a case in point. The "Study of All American Markets," prepared by the 100,000 group of American cities, and the elaborate study of the J. Walter Thompson Company are other illustrations. These various studies of population and income data, as related to individual markets, have resulted in far more accurate planning of sales quotas than previously was possible.

ANALYZING THE INDUSTRIAL MARKET. It is essential, of course, to assemble all the important facts regarding the number and economic status of potential customers, as is undertaken in the studies just referred to. But it is equally essential that this knowledge be supplemented by an analysis of the habits, prejudices, customs, and buying motives of these customers, and the degree to which they may be modified by suggestion and persuasion. If the exchange aspects of marketing are to be scientifically approached, buying habits must be checked and weighed like any other commodity, and there is a growing belief that this is possible.

This analysis is simpler for industrial goods than for consumer goods because of the difference in the complexity of buying motives, which has already been referred to. For industrial goods, the buying motives are predominantly rational. The market analysis involves, therefore, (1) the location of the worthwhile markets, (2) an analysis of the buying habits in those markets, (3) location of the channels of approach to the buyers, and (4) development of complete information on costs, efficiency and economy in use, and the other rational reasons for selection. For example, in analyzing the market for pumps, it is first desirable to classify the uses for pumps according to the liquid handled, the head lift, and the capacity required. Then the industries using pumps may be listed and classified according to the pumping services required. Next, the individual plants in each industry may be studied to find their buying practices and their requirements regarding installations and repairs. As a result of these studies, the manufacturer will have data on which to base his marketing campaign; he may even decide to modify his manufacturing policy in order to reach a larger part of the total market.

ANALYZING A RETAIL MARKET.[2] With consumer goods the analysis takes a slightly different form because of the difference in buying motives. The measurement of a retail market resolves itself into a scientific study of a community. Since the purpose of any retail business is to sell merchandise, thereby making sufficient profit to compensate for the energy and capital expended, it seems only logical that the merchant should desire to obtain all the information possible relative to his market.

Retail business has passed from a seller's market to a buyer's market; the consumer is no longer taking anything and everything that may be pushed his way, but is rather selecting his purchases to suit his own demands. These demands may be justified or not from the viewpoint of sane purchasing, but it is a small part of the merchant's duty to judge them. He may properly give advice to his customers, but his chief function is to satisfy their demands and needs. He can do so most adequately if he makes a quantitative analysis of the market and a qualitative analysis of the consumer demand.

There is often difficulty in determining the community's trading population or trade territory. Frequently, maps are used as a medium for picturing the extent of a market. One notable case of the use of such a map is that of Boston's shopping zone. This map divides the area of the metropolitan city into four zones on the basis of customer's periodic shopping habits. Boundaries of these zones are established by approximation, and the separate zones are termed "daily shopping," "weekly shopping," "monthly shopping," "seasonal shopping" and "mail order." Every city can make a similar division of its trade territory for sales promotion work.

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[2] This section is adapted from the Department of Commerce pamphlet under the same title, published in October, 1924, as Trade Information Bulletin, No. 272.

In analyzing a retail market, the factors commonly considered are population make-up, purchasing power, and competition.

1. Population. Several factors must be taken into account with respect to population make-up. First, the age and sex distribution, which is of importance particularly to merchants specializing in certain lines, as for instance boys' clothing, college toggery, and so on. The method of appeal must differ as between sexes, since women are usually more discriminating buyers than men.

Secondly, the social, racial, and personal habits of the people must be studied. Occupation is of primary importance in such analysis. Railway centers are considered good business points, since their inhabitants are usually steadily employed, and earn good wages. The demand for overalls is ordinarily limited to farmers, artisans, and laborers. It is said that Germans as a race are thrifty and that any store, to cater to their trade, must offer dependable, staple merchandise at reasonable prices.

A third population factor is that of convenience of location. Stores prosper in certain lower East Side locations in New York because a city block there houses more customers than many prosperous towns. Convenience, which the American people demand, is one of the largest factors in trading, and cannot be entirely lost sight of in the measurement of a market.

2. Purchasing Power. A market in its broadest sense means demand, that is, a desire with the compelling force of purchasing power behind it. There are three main sources of income within a community—the factories, the farms, and the

mercantile houses. Most attention is usually given to the first two classes, but in general, the most desirable community for a retail business is one which is not entirely dependent upon either class.

One factor determining purchasing power in a community is the nature and diversification of its industries. A community which specializes in one industry, or closely related trades, may suffer badly if a depression occurs. Further, a community where industries require primarily skilled labor will offer greater per capita buying power than one inhabited predominantly by unskilled labor.

A second important factor determining purchasing power is the size of the market. Some market centers draw trade from a wide area, while others are limited to the urban population.

3. COMPETITION. Undoubtedly one of the vital elements affecting a market is competition. It is not only important to know how many competitors there are, their size and financial strength, but it is necessary to have a full knowledge of the approximate quality of their merchandise and the service they offer to the public.

Who the competitors are, especially those selling similar merchandise, either of a higher or lower grade, will logically present itself as the first question in the mind of the merchant. Other merchants selling a different line of goods may become competitors through the act of substitution. Competitors may then be classified, on this basis, into two groups: (1) direct and (2) substitute, while another grouping might readily be made by classifying them with respect to location, as those within the community and those outside. Among the outside competitors looms the mail-order business as probably the largest, but if the community is near any of the metropolitan centers a still more difficult problem of competition is presented.

Balancing of Production and Consumption through Market Research.—One of the basic problems of our exchange economy is to make production and consumption coincide. The problem is essentially similar, whether considered for each industry as a whole, or from the viewpoint of an individual proprietor within the industry. In either case, its solution involves an accurate anticipation of sales, on the one hand, and a careful planning of production or purchases to meet those sales, on the other.

There are only two methods of anticipating demand, namely, (1) by "observation" of the market, and (2) by securing orders in advance of production or purchase.

1. Market forecasts, estimates of supply, prices paid, quantities purchased and sold, are all data from which to calculate the kind and quantity of goods which profitably may be made or purchased for sale.

The fact-gathering machinery which surrounds the wheat market is a splendid example of the methods of gathering market facts for observation of the market. The United States Department of Agriculture furnishes certain estimates of crop conditions throughout the world, as well as of supplies on farms and in storage. The Department of Commerce estimates the activities of mills, together with stocks on hand and sales of finished products. Private buyers and sellers constantly receive their own reports, both of supply and demand conditions. All transactions on the exchange are made public to everyone. Finally, the judgment of many individuals, based on the above information, is allowed interplay through the constant purchase and sale both of actual grain and of future contracts. The future contracts represent a forecast of the price necessary to just clear the market by the future date. If it were not for the exigencies of crop yields, which are beyond human control, it would be possible for the farmers and millers to plan their operations with reasonable expectation of predictable returns. An equally competent fact gathering in connection with a controllable manufacturing industry would give a high degree of reliability to predictions.

2. When orders are taken in advance, business men are able to plan with considerable definiteness the quantities of raw materials they will need, the number of employees, the amount of working capital, and the plant requirements. In the canning industry, for example, it has been common practice for canners to sell from 60% to 80% of their pack before the opening of the season. This forces the interpretation of marketing conditions onto the merchants, who must decide in advance how large a stock to lay in. The canner, then, may plan his program on the basis of orders received. His requirements for labels, sugar, and quantity of produce for canning are all clearly indicated to him.

Whichever method of controlling production is followed, a study of the market possibilities must be made by some one, and the thoroughness with which such study is made determines the accuracy of agreement between production and consumption. This is a continuous problem in market research.

It is not entirely clear which method is the more precise. In the organized markets, where trained observers are constantly changing their offers or bids to conform with their interpretation of the latest market news, the close of the season generally shows stocks pretty well cleaned up. That is, supply and demand have been made to coincide. On the other hand, when merchants order far in advance of needs, they often make mistakes and either overestimate or underestimate the market. While no exact figures are available, it is probably true that the total carryovers have averaged as large when control has been based upon advance orders as when it has been based upon observation.

This much is clear, however. One of the recent trends in purchasing is toward hand-to-mouth buying. This lessens the chance of judging requirements by advance orders. It is occurring in many industries where, as yet, the opportunities for observing the conditions throughout the market are inadequate. In such cases, danger of maladjustment between production and consumption is increasing.

As a result of this new tendency in marketing, it becomes increasingly important for the individual firm to control its stocks carefully, in keeping with the best available market estimates.

The Technique of Stock Control.—Stock control begins with the taking of an *inventory,* i.e., with the counting of the goods in stock at the beginning of a fiscal period. This inventory may be measured either in terms of physical units or in terms of dollar value; ordinarily it is measured both ways, but for purposes of stock control the physical enumeration is the more important. This is the starting point for subsequent plans.

The second step in stock control is the making of *budgets,* i.e., estimates of (1) the sales which can profitably be made, by months or other periods, (2) the stock which should be on hand at each point of time to accommodate the prospective purchasers, and (3) the orders to be placed for merchandise.

Thus, the control of stocks involves the appraisal of past, present, and future conditions. The estimate of future sales grows, as already suggested, either out of market observations or out of advance orders. The amount of stock which should be on hand or on order to provide for these sales may be approximated by studying the past ratios between stocks on hand and sales, first by groups of stores to set up general standards as already described, and then within the individual store. The development of general standards has already been undertaken by department stores, and the use of such standards by an individual operator becomes a matter of internal market research of a high order.

A third step in stock control is that of *individual piece control.* Stock-sales ratios for departments are very helpful as far as they go, but back of them must be detailed knowledge of the sizes and styles of specific articles which will be called for by the clientele of an individual store. When records of sales are kept over a period of years, especially when several stores with similar clienteles compare their experiences, accurate patterns of anticipated sales may be drawn. By way of illustration, the accompanying diagram of sizes of men's shoes represents the composite sales experience of a group of shoe dealers. Any store with a clientele similar to that of the group can forecast the distribution of sizes in its sales from this table, but each store must check such a listing by its own experience.

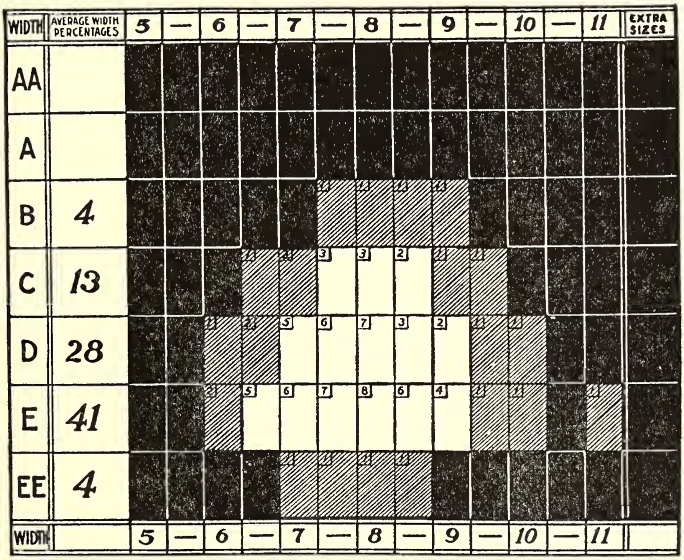

Figure 12. Distribution of Men's Shoes by Sizes and Widths

About 67% of all men can be fitted by sizes indicated in white spaces, 23% in shaded spaces, and 10% in black spaces.[3]

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[3] Paul H. Nystrom, *Economics of Fashion,* p. 460.

After such experience tables have been established, it is necessary to see that the stock is so planned as to meet the demands of the clientele. This may be accomplished through *perpetual piece-control records.* The essential points of such records are shown on the following form, which happens to refer to shoes. Variations in detail will often be required for other commodities, but this example will serve to illustrate the principles involved.

(front of card)

Date	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23	24	25	26	27	28	29	30	31
On hand	10	8	7	23																											
Received			18																												
Sold	2	1	2																												
On order	20	20	2																												
Date																															
On hand																															

Style ________ Source 026 Description ________ Price $10.00 Order No. 79631

(reverse of card)

Size	5	—	6	—	7	—	8	—	9	—	10	—
Width AA												
A												
B					X	X	/					
C				X/	⊗XX	⊗X	XXX	⊗X	XX			
D					X	XX	⊗X	X	X			
E					X	XX	⊗X					
EE												

Key: / indicates size and width on order; X indicates receipt; ⊗ indicates sold or returned to manufacturer, or in any other way removed from stock on hand.

Figure 13. Merchandise Control Card

The upper form is repeated six times to provide for six months' record on each card. Each day the amount received is added to the amount on hand, and subtracted from the amount on order, while the amount sold is subtracted from the amount on hand.

This record makes it possible to see at a glance the condition of stock on hand and on order, the frequency and volume of sales, and the amount of slow-moving stock.

The keeping and interpreting of such piece records have gone far toward eliminating non-saleable merchandise and, thus, the development of a stock-control technique as a form of market research has done a great deal to improve the balance between production and consumption.

Some General Accomplishments of Market Research.—In a recent address on the place of research in marketing, Dr. Paul T. Cherington called attention to two "conspicuous changes in marketing which not only have their roots in established facts, but can hardly be conceived to have developed in a time when some of the results of recent business research were not available for suggestion and guidance."

The first of these recent changes in marketing is the growth of the chain store. Among the concrete factors hastening the development of chain methods is our recently enlarged knowledge of "costs of doing business," "turnover," "mark-up," and so on. Few of the present chains would have started—much less succeeded—had the knowledge of marketing costs and methods remained as vague as it was twenty-five years ago.

The second development to which Dr. Cherington refers is that of selective selling. This has already been mentioned in connection with market analysis for industrial goods—determining the worthwhile markets. Manufacturers are now realizing that the same principle applies to the sale of consumer goods; a recent survey conducted by the Department of Commerce showed that 28% of all independent retail stores did less than $50,000 worth of business a year. Their total business was only 1.68% of the total retail business—a proportion on which manufacturers can afford to expend little sales effort. Until such studies brought to light the real situation in distribution, it was the boast of many manufacturers that their commodities were sold in 90% or more of all stores —a boast to which market research has given the laugh!

CHAPTER 14

COMMODITY EXCHANGES

Shifting of Time Risks to Specialists.—It was pointed out in the preceding chapter that the fact-gathering machinery which surrounds a wheat or cotton exchange provides one method of business forecast, as a result of which risks are reduced. We are now ready to consider in more detail how commodity exchanges reduce risks and transfer them to specialists.

One of the major market uncertainties resulting from the roundaboutness of business is the risk that price will change between the time of production or purchase and of sale. Any change in price is ordinarily a matter of gain or loss to the person who holds title to the goods at time of change; that is, the risk of price change is a function of ownership. If the price goes up, the owner gains—if it goes down, he loses.

Certain marketing institutions have been built up which permit the shifting of this risk to people who specialize in risk taking. Such people are commonly called *speculators.* These speculators operate in the organized commodity exchanges, dealing in such products as wheat, cotton, rubber, linseed oil, butter, eggs, certain livestock products, and some metals.

History of Exchanges.—As will be shown later, trading exchanges are the result of effort to regulate and facilitate trade. The idea of having a central place to trade is by no means new. The Antwerp Bourse was established in the sixteenth century, and the Royal Exchange of London shortly afterward.[1] The English manors and villages had regulated hours of trading even earlier.

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[1] Both were first organized as money market centers. Later the Antwerp Bourse became the center for the spice trade of Europe, and finally it became a grain exchange.

The produce exchanges, which we are interested in here, developed with the existence of large stocks of agricultural staples which exceeded local and temporary demands. With the development of vast new agricultural areas, the distribution of farm products became a specialized industry. Exchanges then developed in response to the need for promptness and convenience in the buying and selling of these commodities.

In the United States, produce exchanges developed as soon as the need for them arose. One of the first attempts to organize trading was made by certain merchants in New York City, who met every Friday morning on a bridge in Broad Street to carry on their commercial activities. The first building to house their organization was erected in 1690. In 1727 the Meal Market, the first real grain exchange, was incorporated; this went out of existence in 1762. The New York Corn Exchange was organized in 1852.

Exchanges developed in other parts of the country as the need for them arose. Thus, in the grain trade, the Chicago Board of Trade dates back to 1848, the Kansas City Board of Trade to 1869, and the Minneapolis Chamber of Commerce to 1881. In order to facilitate the trading in cotton, exchanges were organized in New York in 1870 and in New Orleans in 1871. Exchanges for the buying and selling of other agricultural products have been organized from time to time, so that today they are found in every important trading center in the country. They are variously known as "Boards of Trade," "Produce Exchanges," "Chambers of Commerce," and "Bourses," although the latter name is not used in this country.

Functions of Exchanges.—Among the important functions of exchanges are: (1) to provide a convenient exchange room or trading place for the buyers and sellers of the commodity in question; (2) to regulate the methods of carrying on business, and to provide means for the settlement of trade disputes; (3) to gather all available information regarding production, consumption, shipments, prices, and available stocks, for the common knowledge of all members alike; (4) to disseminate all information gathered, and also all data on exchange transactions, with the utmost promptness to the general public, through the best available means of communication.

Other incidental functions include the establishment of rules governing credit to dealers who buy from or sell to members of the organization; the supervision or performance of certain duties in connection with inspection, weighing, sampling, and grading of the commodities; provision of committees to handle membership problems, and to define certain trade terms, such as "quick" and "prompt" shipment, sale "to arrive," and so on. By indicating what these and other trade terms shall mean, business is facilitated and disputes minimized.

The Minneapolis Chamber of Commerce.—It was pointed out above that exchanges permit the shifting of risks of ownership from certain producers and dealers to people who specialize in risk taking. In order to understand the process by which this is made possible, it is necessary to understand the organization set-up of exchanges, and their method of doing business. For illustrative purposes the modern grain exchange will be described in some detail, with special reference to the Minneapolis Chamber of Commerce.[2]

The Chamber of Commerce of Minneapolis is the second largest grain exchange in the United States, and the largest wheat, barley, rye, and flax market. It is a voluntary association of individuals, engaged in some branch of the grain, milling, or linseed oil business. This association is a business corporation, formed under a statute of the State of Minnesota which provides for associations of this character. This statute does not confer any special privileges upon the Chamber of Commerce of Minneapolis; and under the statute, any number of persons, not less than three, can organize a similar grain exchange in any city, town, village, or county in the state, and they will possess all of the rights and privileges which this organization possesses.

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[2] The authors are indebted to John McHugh, secretary of the Minneapolis Chamber of Commerce, for much of the descriptive material in the following sections.

The Chamber of Commerce of Minneapolis is not engaged in any branch of the grain or milling business. The sole purpose and function of the association is to operate a market place, where the buyers and sellers of grain may transact business with the greatest convenience. The association, as a whole, never buys or sells a bushel of grain, has no interest in or control over the price of grain, and its activities are all limited to the maintenance and operation of the market place.

Exchange Room. The recently enlarged Exchange Room of the Chamber of Commerce of Minneapolis is not only one of the largest, but one of the most modern trading rooms in the United States. This room is approximately 180 feet long, 80 feet wide, and 34 feet high. Nearly one-half of the trading floor is filled with cash grain tables, upon which the sellers display samples taken from the cars of grain.

In the center of the trading room is the space occupied by the North American and Western Union Telegraph Companies. These telegraph facilities enable the members to communicate promptly with the country shippers and with the eastern buyers.

Opposite the telegraph counters are the long distance and local telephones. A very large amount of business is transacted by long distance telephone, between the members, northwestern shippers, and eastern buyers.

In the end of the room opposite the cash grain tables are the "pits," used by those engaged in buying and selling grain for "future" delivery. These pits consist of a series of steps in the form of an octagon. This arrangement of steps enables each dealer in "futures" to see at all times practically all of the other dealers in "futures," which would be impossible if trading were conducted on a flat floor.

Between the pits is the "pulpit," where the official recorder stands, whose duty it is to keep a record of the "future" prices. On his right is an individual who operates a ticker service, by means of which the quotations are sent out to interested parties in the Twin Cities; on his left is a telegraph operator, whose duty it is to send out to the other exchanges of the country the Minneapolis "future" quotations.

Quotation Blackboard. On the south side of the room is the main blackboard, on which are displayed the continuous quotations, which are received from the other grain exchanges such as Winnipeg, Duluth, Chicago, and so on. On this blackboard are fastened telegraph "sounders," from which the Western Union operators receive the quotations sent from other grain exchanges, and immediately post them upon the blackboard.

In addition to these continuous quotations, the exchange secures and posts upon the blackboard statistical information, such as the visible supply of grain, and other data which are important in determining grain values. The Minneapolis cash sales of grain, as reported by the members, are also posted upon this blackboard.

On the same side of the room, but opposite the cash grain tables, is another blackboard, on which an employee posts the future quotations of Minneapolis and the other leading grain exchanges. These quotations are telephoned to this employee by an observer in the "pulpit."

In the extreme end of the room, adjacent to the cash grain tables, are six illuminated "clocks." Also, on the railing of the upper platform of the blackboard are six illuminated "clocks." These "clocks" are arranged to show the leading "future" month's quotations in Minneapolis for wheat, corn, oats, barley, rye, and flax. Both sets of these "clocks" operate simultaneously by electric switches under control of the official recorder in the "pulpit."

These clocks and the cash grain blackboard quotations keep the buyer and seller of cash grain constantly informed regarding the prices in other markets, as well as those being paid at Minneapolis for grain for "future" delivery. On both sides of the pits, and immediately adjacent thereto, are private telephone booths connected directly with the offices of those engaged in the buying and selling of grain for "future" delivery.

NEWSPAPER REPRESENTATIVES. In the center of the room, between the telegraph counters and the cash grain tables, are the desks of the newspaper representatives. Among the most important services rendered to the public by the grain exchanges is the gathering and disseminating of complete market information. No charge is made to the newspapers for the space occupied in the exchange room by their representatives who are offered every opportunity to secure and disseminate through the press all possible information which may be of value to the producers and shippers of grain. The Minneapolis daily papers carry a market page, and these papers going out to the producers and shippers in the Northwest shortly after the close of the market in the afternoon, give to the producers and the general public exceptionally complete information regarding the values of grain in the various markets of the country.

BOARD OF ARBITRATION AND APPEAL. Where such an enormous volume of business is transacted, some misunderstandings are inevitable; the Chamber of Commerce provides for boards of arbitration and appeal, for the purpose of settling disputes arising either between members, or between members and non-members. The individuals acting as arbitrators are under no circumstances permitted to have any interest in the matter in dispute; they are sworn in each case to hear the testimony impartially, and to render a verdict in accordance with the facts. The use of the boards of arbitration and appeal for the settlement of disputes has manifest advantages. The members of the board are, of course, familiar with the rules and regulations of the Chamber of Commerce, and with the customs and practices of the grain trade. Those having disputes to settle are, therefore, fortunate in that: (1) the case is decided by a group of men, all of whom are well informed regarding the grain business generally, and who are hence able to render a more intelligent judgment than would be the case if the matter were submitted to the ordinary jury; (2) fees charged in these matters are nominal, and the expense of arbitration insignificant; (3) decisions are rendered with the utmost promptness, and the long delays incident to court proceedings are avoided.

MEMBERSHIP.—The membership of the Chamber of Commerce of Minneapolis is unlimited. Applicants for membership must be approved by a committee and the Board of Directors. The qualifications are simply that the individual, or firm, or corporation, must possess a reputation for honesty and square dealing, and must show reasonably sound financial standing.[3]

In spite of the vigilance of the membership committees, and the Board of Directors, dishonorable individuals will occasionally secure admission to grain exchanges—as is also the case with any organization. When members are found guilty of misconduct, the directors are empowered to punish such misconduct by fines, suspension, or expulsion. It is manifestly in the interests of producers and shippers, and of the public generally, that reasonably high standards of admission should be maintained by such traders' organizations.

A mistaken impression prevails on the part of some that farmers, or farmers' selling agencies, might have difficulty in securing admission to the Chamber of Commerce of Minneapolis. This is entirely untrue. There are at present a number of farmers holding membership, as well as several farmers' elevator companies. Precisely the same inquiries would be made of farmers or a farmers' elevator company as of any other applicant. It would be necessary only for them to show that those connected with the company were men of unquestioned integrity and honesty, and that they were sound financially.

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[3] Membership in some exchanges is indirectly limited by charging a higher membership entrance fee than such membership costs if bought from a member.

The present membership in the Minneapolis Chamber of Commerce numbers 550, while that of the Chicago Board of Trade is about 1,600. Memberships may be bought and sold between individuals, or between the Chamber and an individual. In either case the buyer must be approved as outlined above. Memberships in the Minneapolis exchange have changed hands in recent years at prices ranging from $3,000 to something over $5,000.

Future Trading Defined.—No other single feature of the commodity exchange is so greatly misunderstood as the buying and selling of goods for "future" delivery. A future contract may be defined as an agreement on the part of the seller to deliver, and on the part of the buyer to receive and pay a specified price for a certain kind and quantity of a commodity at some future time. The terms of the bargain are usually prescribed by the exchange, and formalized in a contract. When —and if—the goods are delivered, the settlement is made on the basis of the price agreed upon at the time the contract was made.

"Futures," then, as the term is generally used in grain exchanges, are contracts for the purchase and sale of a product to be delivered during some future month. For grain, these "delivery" months are: May, July, September, and December. Contracts could, of course, be made for the delivery of the commodity in some other months than the above mentioned; considering the time of the crop movement, however, certain months have proved to be convenient for "hedging" purposes, with the result that the bulk of the trading in grain "futures" is for delivery in one or the other of a few specified months.

At the time of the sale, each party has to put up a "margin" to show good faith, and insure against non-performance. The "margin" deposit is usually made with the exchange, which regulates the minimum amount and place of deposit of margins.

Contract Grades.—Future contracts usually imply delivery of a particular grade of the product, and the price agreed upon is based upon this "contract" grade. Other grades may be delivered at the option of the seller, with the understanding, however, that a certain premium or discount—as defined by the exchange—shall be applied if other than the contract grade is delivered. A definite schedule of grade premiums and discounts is found in all the leading exchanges; such schedules may be altered by the exchange at any time. The following table shows the premiums and discounts prescribed for the various deliverable grades of wheat on the Minneapolis Chamber of Commerce in 1929.

WHEAT

No. 1 Hard spring wheat	2 cents above base
No. 1 Dark northern spring wheat	1 cent above base
No. 1 Northern spring wheat	Base or contract grade
No. 2 Dark northern spring wheat	2 cents under base
No. 2 Northern spring wheat	3 cents under base

Units of Trading.—Following is a table showing the units of trading for future contracts for some of the most important commodities:

COMMODITY	EXCHANGE	UNIT OF TRADING
1. Wheat, corn, oats, barley, rye	Chicago Board of Trade	5,000 and 1,000 bushel lots[4]
2. Cotton	New York and New Orleans Exchanges	100 bales of 500 lb.
3. Raw sugar	New York Coffee and Sugar Exchange	50 tons of 2,240 lb.
4. Coffee	New York Coffee and Sugar Exchange	130 bags of 250 lb.
5. Butter	Chicago Mercantile Exchange	Carload of 300 tubs
6. Eggs	Chicago Mercantile Exchange	Carload of 400 cases
7. Copper	London Metal Exchange	25 tons

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[4] 1,000 bushel lots are called "job lots"; prices for these lots are not registered as official quotations.

Delivery on Future Contracts.—As pointed out above, the future contract contemplates delivery of the commodity during a given month. The exact time within the month is at the option of the seller, however. It is understood between the buyer and the seller that delivery, in the case of grain for example, shall be in the form of a warehouse receipt, issued by a licensed warehouse located within switching limits of the exchange. This public licensed terminal warehouse must also be "regular" under the rules of the exchange, i.e., be qualified as fulfilling the exchange specifications.

At the time of delivery, the warehouse receipt shall have five clear days before an additional term of storage accrues against it; that is, while the seller may choose the date of delivery, he must pay the storage charges for the five succeeding days. During these five days the buyer may have the grain loaded into cars; if he leaves it in the warehouse after the five days elapse, additional storage accrues, which he must subsequently pay.

The seller has, therefore, three options in the matter of delivery on a future contract: (1) as to the exact date of delivery; (2) as to the place of delivery (since he can deliver a receipt on any "regular" warehouse); and (3) as to grade of product to be delivered.

Not all future contracts terminate in actual delivery of the product. In fact, a report by the Grain Futures Administration of September, 1924, shows that the total transactions in the May future for 1924 in Chicago settled by delivery were as follows:

For all grains combined delivery was less than 2.7%, for wheat it was somewhat less than 0.6%, for corn somewhat less than 0.4%, for oats less than 1.6%, and for rye less than 4.1%. The same source states that delivery on 1924 May futures in Minneapolis was less than 1%.

The principal reason why delivery is not made on future contracts in wheat is that the buyer does not want to accept delivery. Either he is a speculator, in which case he resells before the delivery date, or he is a miller, in which case he wants to purchase a particular lot of grain which meets his requirements precisely, rather than to accept whatever grade of grain may be legally delivered to him under the terms of the contract. Future contract grades do not exactly describe the milling quality of the grain, and for that reason millers prefer to buy specific lots of grain after inspection and analysis, even though they may pay materially more for a particular carload of No. 1 northern spring wheat than the quoted contract price.

Clearing Associations.—Since grain is not actually to be delivered and accepted on all future contracts, a method of offsetting one contract against another is required. This is accomplished by means of a very important organization known as a clearing association. This organization is usually a corporation, and has the privilege of membership in the exchange. The purpose of such an organization is about the same as that of the clearing houses operated by banks, namely, to effect a cancellation of obligations with a minimum amount of cash transfers. Any member of the exchange may become a member of the clearing association, but such membership is not compulsory.

When two members of the exchange make a contract for future delivery, and both are members of the clearing association, they each make a report of the trade to that organization. A reports the sale to B of 5,000 bushels of wheat for December delivery at $1 per bushel; B makes a similar report of the purchase from A. The clearing association records all such reports, and strikes a balance at the end of each trading day. The total amount bought must then equal the amount sold, or "longs" and "shorts" must be equal. The report would appear about as shown in Figure 14.

	A		B		C		D		E	
	Bought	Sold	Bought	Sold	Bought	Sold	Bought	Sold	Bought	Sold
	5,000	5,000	15,000	25,000	10,000	5,000	10,000	10,000	10,000	15,000
	10,000	15,000	5,000	5,000					10,000	5,000
									10,000	
Total	15,000	20,000	20,000	30,000	10,000	5,000	10,000	10,000	30,000	20,000
Net Position		5,000		10,000	5,000				10,000	

Figure 14. Daily Clearance Association Report

Margins.—In the above example, total purchases and sales are equal, but some of the traders have either a "long" or a "short" account. A is "short" 5,000 bushels, B is "short" 10,000 bushels, while C and E are "long" 5,000 and 10,000 bushels, respectively. Each of the four must pay to the association the margin per bushel required by the organization on the net amount which they are either "long" or "short." This margin is ordinarily 10% of the closing price. Since D, on the other hand, has bought and sold the same amount he is neither "long" nor "short" in his net position for the day and need not put up any margin.

If, in the above example, A had sold 5,000 bushels at $1 per bushel and C had bought 5,000 bushels for $1, a subsequent rise in price of 1 cent would mean a paper loss for A and a paper gain for C.[5] This would permit the clearing association to require A to pay an additional 1 cent per bushel, or $50 margin, in order to keep itself adequately protected in case of further price rises. C, on the other hand, could be paid $50 by the association since his margin of safety would be enhanced. Whether such balancing payments are made daily or not so often is, of course, a matter regulated by each individual association.

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[5] A need not necessarily have sold to C. The clearing association books would, however, show such profit and loss.

If two traders are *not* members of the clearing association, each party has a right to require that a margin be put up by the other party. These funds are then deposited with some one designated by the exchange.

A person who is not a member of an exchange, but who wishes to buy or sell, must do so through a regular member of the exchange, usually a commission house in the case of grain and produce exchanges. The commission house then requires the customer to put up a margin, usually equal to about 10% of the price of the commodity that day. In periods of high or of widely fluctuating prices, the margin required may be much higher.

Purposes of Future Trading.—Future trading is carried out for three distinct purposes: (1) to insure either that some one will buy a good from you or sell a good to you at a future date; (2) to accept the risk of price changes incidental to ownership of commodities, without the necessity of actually accepting the good—*speculation*; (3) to enable one to shift the risk of price changes, either for goods owned now but to be finally disposed of at a future date, or for goods which will be needed later—*hedging*. It is in this latter purpose that we are interested here, because it makes possible certain modifications in marketing methods; it is also a very important method of shifting risks. Consider, for example, an elevator operator who has purchased 5,000 bushels of grain from farmers, and for which he has paid a certain price per bushel. The gross margin taken by the elevator must cover necessary expenses, such as building costs, wages, interest, and so on. Since grain prices are constantly fluctuating, the elevator operator has no assurance that he will be able to sell the grain at a sufficient price to cover all costs. Further, he is specializing in one activity, that of operating an elevator, and probably knows little about price forces and trends; his risks are therefore great. Through the mechanism of future trading, the elevator operator is enabled to transfer most of that risk of price change to people who specialize in such activities, i.e., to speculators. Whoever buys a commodity for purpose of resale is speculating, that is, the owner of the good faces the possibility of loss or gain through price changes. Legislation can, therefore, never destroy speculation, as it is something that is necessarily connected with the ownership of any commodity held for resale.

It is the purpose of the following pages to explain and illustrate how, through future trading and hedging, risks of ownership are transferred. Grain will be used as an example throughout, although some other commodity, fulfilling the prerequisites of exchange trading, could be used.

Cash and Futures Markets.—Future trading was defined above as an agreement to buy or sell a certain good at some future time. That, obviously, is not the same as the actual buying and selling of a commodity over the counter. In the former case, only *agreements* to buy or sell are traded, and no actual commodity changes hand. Further, since the agreements call for purchase and sale *in the future,* the price which is offered or asked must depend upon what actual supply and demand conditions are *expected* to be. For example, a bid of $1 per bushel for a May future, made in January, means that the buyer expects conditions in *May* to warrant that price. Thus, prices in the futures market are based on *anticipated* supply and demand conditions.

Prices in the *cash* or *spot* market, on the other hand, are based on actual conditions on the day of sale. Buying and selling in this market are, therefore, essentially similar to any ordinary over-the-counter trade.

As pointed out above, in the Minneapolis Chamber of Commerce the futures market is in the "pit," while the cash market is in another part of the same room. Traders in each market are, therefore, at all times conversant with conditions in the other.

Cash and Future Prices.—While the cash and future prices are set in two different markets, there is normally a certain definite relationship between them, based upon the cost of carrying the commodity from the present to the future date. The future price today reflects estimates as to the price which will cause the realized demand to equal the supply available for consumption to the future date. The cash price will generally tend to be below this price by the amount that it will cost to carry the commodity to the future date; this is true because no one will buy the actual commodity today unless there is a reasonable hope that the price will increase at least enough to pay storage, insurance, and interest costs. For grain, the average cost of carrying is about 2 cents per month. At any time, therefore, future prices will normally tend to be above cash prices by the amount of 2 cents per month, i.e., if a December future is worth $1 on October 1, the cash price on the same date should be less by two months' carrying charges, i.e., it would be 96 cents. If, on October 2, the future price has risen to $1.04, the cash price should be $1, or still 4 cents below the future. This "normal" relationship between cash and future prices may be illustrated by Figure 15.

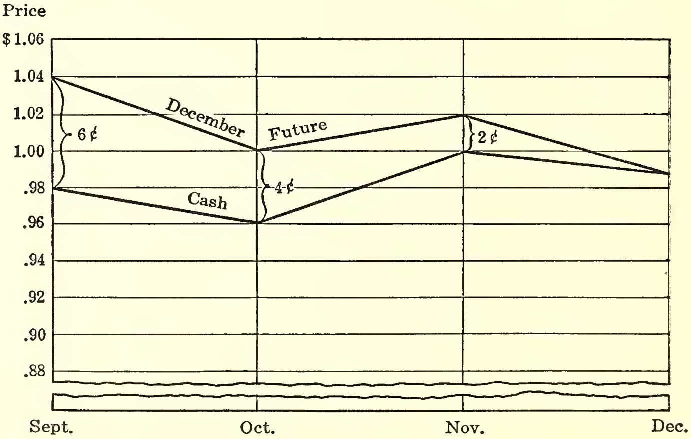

Figure 15. Ideal Relationship Between Cash and Future Prices

The diagram assumes a carrying charge of 2 cents per month. On September 1, the spread would, therefore, be 6 cents, to cover costs of carrying for September, October, and November. On October 1, the spread would be 4 cents, to cover 2 months carrying; on November 1, the spread would have narrowed to 2 cents; on December 1 the two would obviously be the same.

It is further noticed in the diagram that the same relationship between cash and future prices exists regardless of price fluctuations. It is this fact which is the basis of hedging operations, and which makes it possible to shift risks of ownership to speculators.

Hedging Defined.—Hedging refers to the simultaneous purchase and sale, and subsequent sale and purchase, of two different things—the actual commodity and an agreement to sell that commodity at a future date—in two different but related markets—the cash and futures markets. The prices in these two markets are expected to behave in such a manner that losses on the transactions in one market are offset by gains on the transactions in the other; to the extent that the same forces affect both of these markets alike, a change in prices in one market should normally be accompanied by an equal change in the other.

A Perfect Hedge.—Consider, for example, a terminal elevator which has purchased a carload of grain. It expects to gain 2 cents per month from the sale of that grain whenever it is sold. The question arises: How can it assure itself that gain? Since there normally exists a definite relationship between cash and future prices, the elevator could immediately sell an equal quantity in the futures market, which should be higher by the amount of 2 cents per month. For example, if the grain was purchased September 1 at $1 per bushel, the sale in the futures market on the same date should realize $1.06 per bushel, which is the amount necessary to assure the elevator a monthly 2 cents per bushel carrying income. In that way, the risk of loss or gain is transferred to the person who bought the future contract.

The elevator could carry the grain for three months and then deliver it to fulfill its contract.[6] Usually, however, it becomes necessary to move the grain out before the time specified in the contract. In this case, the grain is sold in the cash market and a future contract is simultaneously purchased to offset the previous future sale. If the price has fallen, the elevator will sustain a loss on its cash transactions. Assuming, however, that the expected relationship between cash and future prices has prevailed, the loss will be offset, or compensated, by an equal gain on the future transactions. The following arithmetical illustration shows the complete transactions.

Purchases		Sales	
(1) Sept. 1 Bought wheat at...	$1.00	(2) Sept. 1 Sold Dec. future at.	$1.06
(4) Oct. 1 Bought Dec. future at...............	1.02	(3) Oct. 1 Sold wheat at.....	.98
	$2.02		$2.04

In this case the elevator lost 2 cents per bushel on the transactions in the cash market, but made 4 cents per bushel on the futures transactions, a net gain of 2 cents per bushel. This 2 cents is just sufficient to repay the elevator for carrying the grain one month; in other words, the hedging operations have insured the elevator its legitimate trade gain of 2 cents per month.

Since cash and future prices have moved down together, what the elevator lost in one market it has made up by a gain in the other. The theory underlying the hedging operation—the compensating of risk—is, therefore, the simultaneous and related movements of prices in the cash and futures markets. Whenever they move as anticipated, hedging gives protection to the trader who is primarily interested in a payment for his special activities and not in speculating on price changes.

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[6] That would, of course, not constitute a hedge, but merely delivery on a future contract.

Other Examples of a Perfect Hedge.—In the previous example, prices were assumed to have fallen. If prices had risen between the time of purchase and sale of the commodity, hedging would likewise prevent any extraordinary gain for the terminal elevator, assuming, of course, that cash and future prices had moved in harmony.

Purchases		Sales	
(1) Sept. 1 Bought wheat at...	$1.00	(2) Sept. 1 Sold Dec. future at	$1.06
(4) Oct. 1 Bought Dec. future at...............	1.08	(3) Oct. 1 Sold wheat at.....	1.04
	$2.08		$2.10

In this case, the elevator makes 2 cents per bushel, the amount necessary to compensate it for carrying the grain for the month of September (assuming 2 cents per month carrying charges). Figure 16 visualizes these offsetting transactions.

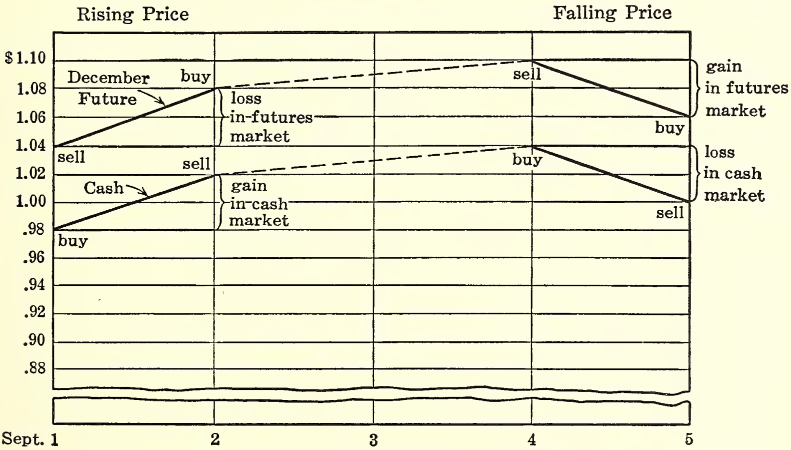

Figure 16. Illustration of a Complete Hedging Transaction First for a Rising, Then for a Falling Market

In the diagram, the purchase and sale of cash grain are shown as taking place on succeeding days, thus avoiding any carrying charges. The illustration shows that hedging must give complete protection whenever cash and future prices move in harmony; what is lost in one market must be gained in the other, whether prices rise or fall.

Country Elevator Hedging Example.—Wheat prices at any country point tend to be equal to the nearest central market price, less cost of transportation to that market. A country elevator buys grain from farmers, and calculates a margin between the purchase and sale price amounting to a certain number of cents per bushel, enough to compensate for all outlays entailed in handling the grain. The operator is not interested in speculating in price changes, but in protecting the elevator's legitimate trade margin and, to this end, he hedges.

In the following example, the margin taken for elevating expenses, such as labor, rent, and so on, is assumed to be 5 cents per bushel. Transportation cost between the country point and the central market is assumed to be 15 cents per bushel. If, on September 1, the cash price, say in Minneapolis, is $1 per bushel, the cash price paid at X will be less by the amount of the freight charges and the margin taken by the elevator, i.e., the price will be 80 cents per bushel. In order to hedge his purchase, the elevator operator must immediately sell an offsetting future in Minneapolis—usually handled by some commission firm upon receipt of wire from the elevator. Since the wheat in this case is bought at a country point, the spread between cash and futures prices should be the elevator margin and transportation costs to the central market plus 2 cents per month carrying charges. When the grain is sold, the elevator may consign it to a commission merchant, who sells it on the exchange floor; a corresponding future is then immediately bought by the commission merchant. The complete transactions would be as follows:

Purchases		Sales	
(1) Sept. 1 Bought wheat at X at	$ .80	(2) Sept. 1 Sold Dec. future in Minneapolis at	$1.06
(4) Oct. 1 Bought Dec. future at Minneapolis at	1.00	(3) Oct. 1 Sold wheat at Minneapolis at	.96
	$1.80		$2.02

The gross gain in this case is 22 cents per bushel. Of that amount, 15 cents per bushel is paid by the elevator for transportation charges to Minneapolis; 5 cents per bushel is the elevator's margin which covers the operating expenses; the other 2 cents pays for carrying the grain one month, September, i.e., it covers interest, insurance, waste, etc. Again, the hedge has been perfect, and the elevator has assured itself of the necessary operating margin and carrying charge, totaling 7 cents per bushel. Had it not hedged, it would have lost money, since the cash selling price was only 16 cents per bushel above the purchase price, while a 22-cent spread was necessary to insure the legitimate trade gain.

Adequacy of Hedging.—Any divergence from the anticipated, simultaneous, movements of cash and future prices results in an imperfect hedge. Divergence arises even in so well-organized a market as a grain exchange. For example, cash prices for old grain near the end of the season are not affected by the same forces as are future prices for the new crop. While future prices are still controlled by basic factors, such as the reported size of the new harvest, cash prices depend upon the supply of grain actually available at the moment. If the anticipated harvest is large, while the supply remaining is small, cash prices may be *above* future prices. Since they normally are below, the tendency is for a reversal to the normal relationship. Hence, the two prices at such times do not always move simultaneously. It occasionally happens also at any time during the crop year that supplies of cash grain are short, due to traffic tie-ups or other causes. At such times, again, cash prices get out of line with future prices. Moreover, price adjustments to new conditions are generally more prompt in the future than in the cash market. This leads to frequent, but minor and short-lived, departures from expected spreads.

There is still another reason why hedges are seldom perfect. As pointed out above, trading in the futures market must be in units of at least 1,000 bushels. A country elevator seldom purchases grain in such large quantities. It may, therefore, take several days to acquire the quantity necessary to make a hedge. In the meantime, prices may have fluctuated, either up or down, with the result that the necessary relationship between cash and futures holds true for only part of the purchases.

While any one hedge is seldom perfect, over a period of one or more seasons the losses tend to offset the gains, so that the elevator operator will break even in his hedging operations over a period of time. The fluctuations in spread between cash and future prices are much less violent than the fluctuations in the cash price which come with the lapse of time.

The Services of the Speculator in Hedging.—In the hedging process, the elevator company, which buys cash grain for resale later, immediately sells a future contract. The purchaser of this future contract is generally a speculator, rather than a grain dealer who expects to accept delivery on the contract. So far as the risks of price change are concerned, the speculator becomes the owner of the grain. If he holds the contract to maturity, he must accept delivery of the grain, for which he has no use except to resell it. If the price has fallen in the meantime, he must resell at a loss. If he elects to sell another contract for a like amount of grain prior to the maturity date, the two will cancel each other so far as he is concerned, and he need neither make nor accept delivery. This is what, in all probability, he would do. But here again, if the price has fallen he can only sell at a loss. This is illustrated in the example given above for a falling market, in which the elevator avoided loss by hedging. When the elevator sold a future to a speculator at $1.06 and bought another future one month later at $1.02, speculators lost 4 cents per bushel.

When prices rise, on the other hand, the speculators gain. In such cases, the hedger gives up his opportunity to make a profit on the change in price, to the advantage of the speculator. The hedger is willing to do this in order to escape the danger of loss on a falling market. As already pointed out, he is interested in the income from storing and merchandising the grain, rather than in the possible winnings from favorable price changes.

Individual speculators may either buy or sell at a particular moment, depending upon whether they expect prices to rise or fall. The judgment of *all* the speculators is never the same—at all times some are willing to buy while others will sell. It is this fact which maintains an active market and it is these continuous expressions of judgment which keep prices in line.

Certain speculators are usually right in their judgments. These men prosper from speculation. On the whole, however, the entire group of speculators must lose. The speculative gains of the shrewd must always just offset the speculative losses of the unsuccessful, except that the expenses of making the speculative trades must be paid. The total speculative gains are less than the total speculative losses, therefore, by the total amount of these expenses. It is only because men are incorrigible optimists, expecting always to do better than the average, that the speculative side of a futures market can be maintained.

Regulation of Future Trading.—It was pointed out above that future trading is a much misunderstood marketing mechanism. The futures markets are probably the most price-sensitive of all markets; it has, therefore, been alleged that they lend themselves readily to manipulation by influential dealers. It has further been alleged that membership in the exchanges is not open to all producers. A senator has characterized the Chicago Board of Trade as "the world's greatest gambling institution," maintained in order to allow speculators to take advantage of producers, and particularly farmers.

These charges have resulted in many public investigations, and have led the exchanges themselves to adopt stringent regulations. The government has enacted legislation dealing with exchanges. For example, the Futures Trading Act, passed in 1922,[7] is designed to regulate trading in futures, and to define where future trading may be carried on. There is no interference with hedging or with the ordinary buying and selling of contracts for future delivery. Many types of transactions are forbidden by the act, however, and any evidence of undue manipulation or of attempts to "corner the market" are promptly dealt with. The Secretary of Agriculture is, further, given authority to examine the records and books of exchange members, and to require necessary reports.

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[7] An earlier act passed in 1921 was held unconstitutional.

The Grain Futures Administration, in its report for 1924, stated the general objects of the Grain Futures Act as follows:

> (1) To obtain for the use of Congress and the enlightenment of the public authentic and comprehensive information regarding trading in grain futures. As some writers expressed it, Congress intended "to remove the mystery" from grain futures. To accomplish this object, the law contains provisions requiring the making of adequate original records of cash and future transactions on boards of trade, the keeping of such records for a sufficient length of time, and the rendering of reports based thereon. Such records must show all the details and terms of such transactions. They must be kept for three years or longer, if required by the Secretary of Agriculture, and must be open to inspection by properly authorized representatives of the Departments of Agriculture and Justice. Proper safeguards are provided against the unauthorized publication of information which would separately disclose the business transactions of any person, or trade secrets and names of customers.
>
> (2) To prevent the dissemination by boards of trade or their members of false or misleading reports concerning crop or market information or conditions that affect the price of grain.
>
> (3) To prevent the misuse of facilities of grain futures exchanges in ways which result or tend to result in "sudden and unreasonable fluctuations in prices" or in the cornering of grain.
>
> (4) To make the contract markets open markets for producers by preventing the arbitrary exclusion of properly formed and conducted cooperative associations of producers engaged in the cash grain business which act for their members on a patronage basis.
>
> (5) To limit trading in grain futures to boards of trade located at terminal cash grain markets where there are available official inspection service and satisfactory grain marketing conditions.

Evidence as to whether the Grain Futures Act has either improved or injured the conditions in the grain trade is contradictory. Probably it is still too early to draw final conclusions. At any rate, it is still a possible and common practice for elevator companies and millers to hedge their cash transactions in the futures market. This practice still gives protection against price changes; whether the degree of protection is greater or less than formerly is indeterminate from any reports so far available.

Extent of Future Trading.—A study of the data made available by the Grain Futures Act shows that Chicago is our most important futures market for wheat, accounting for slightly more than 85% of the total trading; Minneapolis comes second, and Kansas City, Duluth, St. Louis, and Milwaukee follow in the order named. Chicago also leads in respect to corn, oats, and rye futures. Duluth is the most important flax and durum futures market.

The data further show that the average annual volume of wheat represented by all future contracts amounts to approximately fifteen times the size of the wheat crop, or to about thirty times the receipts of wheat in the primary markets. For the other grains and for cotton, the ratios between volume of future contracts and actual crop or receipts are usually considerably smaller, although cotton futures often amount to ten times the cotton crop.

The comparison of volume of future contracts and size of crop has no particular significance as such. Since future trading, as shown above, is an important means of transferring risks, it is to be expected that a hedge will be made by every owner of the product as it passes through the channels of distribution. Since every hedge involves both a purchase and a sale in the futures market, it is readily seen that the volume of future trades must necessarily be much greater than the amount of the actual commodity brought to market.

To show further the extent of future trading, it may be pointed out that "in one day, probably not very different from many other days, futures dealings on the Chicago Board were participated in by 456 traders, residing in 37 states and Canada, England, France, Australia, Holland, Czecho-Slovakia, and Cuba. It is not only a national but an international institution."[8] The same writer points out also that the Cooperative Wholesale Society of England, the greatest cooperative enterprise in the world, holds a membership in the Chicago Board of Trade.

The Final Adequacy of Exchange Marketing.—From this description it is evident that the modern grain exchange embodies many of the essentials of perfect marketing machinery.

1. It is designed to give market information promptly and accurately. A large number of men are engaged in the marketing of grain, including farmers, grain merchants, speculators, and millers, so that every type of opinion is represented in the trading. Moreover, there is every opportunity for rapid collection and interchange of information regarding sales, prices, present and future supplies, and demand.

2. It is also designed to equalize bargaining power between purchasers and sellers. In the first place, the farmer, who is a small operator and might be disadvantaged, is represented by a commission man, who is an expert in the grain trade, and whose continued business comes because he can get better prices for his principal than can other agents.

Then, too, the farmer is always able to sell his grain promptly and therefore he is not at the mercy of the millers who have larger capital reserves. This claim is supported by the facts that, although 72% of the United States wheat crop is sold by the farmers in a 90-day period following harvest, yet the price is not depressed by such large sales. A large proportion of this grain is bought by middlemen—grain merchants or elevator companies—who hold it in storage until millers are ready for it. These middlemen accept responsibility of bridging the lack of fit which exists between the desire of the farmer to sell wheat and that of the miller to buy it. It makes little or no difference to them how rapidly wheat is offered for sale on the exchange. The question of importance to them is the total amount which will be offered and purchased throughout the season.

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[8] Will Payne, in *The Saturday Evening Post,* September 7, 1929.

For instance, a recent study of the operations on the Chicago Board of Trade, covering the ten years 1904-1914, shows a complete lack of correlation between receipts of grain by the exchange and prices on the particular day; 2,998 days were included in the study. During this period, there were five days when there were no grain receipts, and six days with receipts over 1,000,000 bushels each. On the five days of no receipts, the following things happened: the price dropped twice, rose twice, and remained unchanged once. On the six days of record receipts the price dropped twice, rose once, and remained unchanged twice. In other words, neither large nor small receipts had consistent effect on the price. There may be cases, however, when grain moves so rapidly to the central markets that storage facilities become overcrowded, so that cash prices temporarily fall.

Another indication that the wheat producer is not disadvantaged by his desire to sell soon after harvest is found in the average monthly prices, as published by the U. S. Department of Agriculture. The farm prices of certain agricultural commodities have been averaged by months for a forty-year period, that is, an average has been taken for the forty Januarys, then the forty Februarys, and so on for all the months. A comparison between these monthly averages shows that the spread between high and low months is relatively low in the case of wheat and cotton, which are sold on exchanges, and much higher in the cases of barley, apples and potatoes, which are not so sold. The low monthly average for wheat comes in

September, and the high in May, the increase being only 6%, or at the rate of 8% a year. This average increase in price will not pay the cost of carrying the grain to the later month, so that, on the average, farmers seem to have gained rather than lost by selling this crop early. Cotton, also, shows a low rate of increase between months, on the average—at the rate of 12% a year. Barley, on the other hand, increases from the month of lowest average price at the rate of 28% a year, while apples and potatoes increase at the rate of 90% a year. Perishability and high cost of storage are doubtless material factors in the price change with these latter two products, but the lack of organized selling is also very important.

CHAPTER 15

TRANSPORTATION AND MARKETING

The Importance of Transportation.—Transportation may be defined as the process of getting *people* and *things* together, in point of space. It permits general, widespread consumption of commodities which are produced in localized areas.

National development in the United States has depended largely upon transportation facilities. Proof of this statement is abundant in the story of the movement of the American people into the West. Almost from the first, the primary question in the westward course of population and industry has been that of transportation facilities. Moreover, since the economies of large-scale production are dependent upon broad markets, transportation shares with demand manipulation a vital part in present American prosperity.

The early settlers beyond the Alleghenies depended largely upon the rivers as a means of travel into the country, and likewise for getting produce to and from the markets. Before the days of the steamboat, transportation was mainly downstream, and with good reason it was predicted that New Orleans was destined to be the greatest port on the Atlantic Coast. The geography of early agriculture of the whole country is outlined by the water courses.

Before the days of the railroad there were numerous instances of freight hauling at the rate of $100 a ton for distances of less than half-way across the continent. For instance, it cost $10 a barrel to carry flour up the Missouri from Kansas or Iowa points to Fort Benton, Montana. These rates acted as a great stimulus to the development of agriculture in the West during the decade or so after the rush to California. The cost of getting food into the territory was so high as to make farming and gardening more profitable than washing gold.

Senator Benton of Missouri declared, about the time of the Oregon settlement, that God Himself had set the Rocky Mountains as the western terminus of American expansion. And yet, today, with the cheapest railway service in the world, the United States has to a large extent become a single economic unit; the stadium at the University of Minnesota is fitted with redwood seats from the forests of the Pacific Coast, and on the coast they use International Harvester machinery manufactured in Illinois.

Before the days of cheap transportation, small packing plants were to be found throughout the Ohio and Mississippi valleys, without concentration at any central points; agricultural implements were manufactured in a hundred scattered cities; iron was mined in a half-dozen districts; wheat was milled within a short distance of where it was produced. To an even greater extent, each community depended upon itself for potatoes, fruits, and vegetables. In other words, the family and the community were largely self-sufficing.

Growth of Transportation and National Development.—For some years we have been molding the scattered units of America into a single going concern. We do our gardening, in part, near the great cities and the balance in the regions of long summers. We get our bread from Kansas and the Dakotas; butter from the land of the Lakes; meat from the corn belt and from the Southwest. Likewise, we do our packing in a few great centers and redistribute the meat. Iron comes from Minnesota and goes to every state in the Union. More than half of the agricultural implements are made in two states, and these states furnish no raw materials used in the process.

Transportation in the United States.—As already pointed out, the earliest transportation in the United States depended upon *natural waterways*. America is unusually well supplied with this means of transportation. The ocean coast-line, with all its undulations, measures about 64,000 miles, thus affording remarkable harbors for shipment of goods into and out of the country and along its shores. The Great Lakes are probably the most important inland waterway in the world. There are 295 rivers with a combined length of over 25,000 miles of "navigable" water, although much of this is navigable for very small boats only. All this, however, was quite inadequate for the development of the huge empire within our national borders. Especially the traffic from the early settled and industrialized East to the western frontier required other channels of distribution.

In the late eighteenth and early nineteenth centuries, *canals* were rapidly built for navigation. Six canals had been built in the United States before 1807, but the canal era really commenced with the opening of the Erie Canal in 1817, continuing actively until about 1840. In all, more than 4,000 miles of navigable canals were constructed. From 1840 to 1900, there was little further development of inland waterways. Many of the canals were abandoned following the Civil War, mainly because they could not stand the competition of the newly established railroads.

The New York State Barge Canal was opened in 1918. This is the old Erie Canal, reconstructed at a cost of $231,000,000 to permit the use of 1,000 ton barges. It is the most pretentious inland waterway construction in the United States.[1]

Just now the active operation on the lower Mississippi River, the contemplated development of a nine-foot channel in the upper Mississippi, the proposed Great Lakes-Ocean waterway, and similar proposals are reviving marked interest in this method of transportation, especially in relation to foreign trade.

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[1] In 1926, the New York State Barge Canal transported 1,935,000 net tons of freight. This freight was carried at a direct charge to shippers which was materially less than competing rates by rail, but the people of New York State made up a considerable operating deficit through taxes. The canal has not paid expenses at any time, and is now generally recognized as a financial failure. See S. S. Wyes, *Fundamentals of Transportation*, 1928, p. 15.

Even with these developments, however, railroads are by far the most important part of the entire transportation system.

The *railroad* excels earlier forms of transportation in several respects. It excels in adaptability, for it can go over mountains or tunnel through them; it is superior in certainty, for it suffers no seasonal stoppage of traffic; for speed it far surpasses any known form of water transport. In many cases it furnishes the cheapest available transportation.

As a result of these physical advantages, railroads soon surpassed any other form of domestic transportation. The miles of main-line railroads in operation at different times during the past hundred years are shown in the following table:

Year	Total Miles in Operation[2] (main-line track only)
1830	23
1840	2,818
1850	9,021
1860	30,626
1870	52,922
1880	93,267
1890	156,404
1900	192,556
1910	240,831
1920	259,941
1925	258,600

The most recent development in commercial transportation is the *motor truck*. In 1927, there were 2,764,000 motor trucks registered in the United States; this was more than twice the number in 1920; in 1928 the number had increased to 3,114,000. There is some reason for believing that motor trucks are seriously injuring the railroads, although only 10% or less of the trucks hold themselves out as common carriers. In this connection it may be noted that no material increase in miles of railroads operated occurred between 1910 and 1925. It is the more common belief, however, that trucks have for the most part evolved a distinct field of transportation—that of short hauls and the handling of small shipments between points not served by rail, and on traffic which is not as profitable for the railways as other traffic. In fact, in many cases, truck lines arose as feeders for railroads.

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[2] *Statistical Abstract,* 1926, p. 379.

"Although other factors beside length of haul influence the proportions of total tonnage hauled by motor trucks and rail lines respectively, operating in the same territory, there is a tendency for the proportion of motor truck tonnage to decrease with increase in distance. This is indicated by an analysis of the railroad and motor truck tonnage for an average month in 1925, between Columbus, Ohio, and the 30 cities in Ohio located from 7 to 134 highway miles from Columbus. For hauls of less than 20 miles, 84.5% of the total tonnage was transported by motor truck; between 20 and 30 miles, motor truck tonnage was 54.7% of the total; and for hauls of 40 to 59 miles, 60 to 99 miles, and 100 miles or over, motor truck tonnage was 32%, 24.2%, and 2.3%, respectively, of the total. As the percentage of motor truck tonnage decreased with increase in distance, both rail carlots and L.C.L. (less than carload) tonnage registered an increase. No appreciable amount of L.C.L. tonnage was noted under 40 miles, in the total hauled by rail. Between 40 and 59 miles, the L.C.L. tonnage was 5.6% of the total tonnage, and this ratio increased to 20.3% for distances of 100 miles or more."[3]

One of the most important uses of motor trucks is to give store-door delivery from large city wholesalers and manufacturers in the small cities and towns in the trading area.

It is estimated that trucks handled 16 billion ton-miles of freight in 1928. This may be compared with the ton-miles of revenue freight carried by the "Class 1" railroads in 1928, which totaled 475 billions.[4] In no previous year have the railroads carried so great a volume, in spite of the development of trucking.

Pipe lines are another important transportation facility. In 1929, there were over 80,000 miles of pipe lines operated in transporting crude oil. In addition, lines are being constructed rapidly for long-distance movement of natural gas.

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[3] Interstate Commerce Commission, *Reports*, 1928, p. 798.

[4] Dept. of Commerce, *Yearbook*, 1928, p. 588. The estimated total for 1929 is 490 billion net ton miles—the greatest in railroad history.

Present Volume of Railway Traffic.—In 1928, there were approximately 2,362 million tons of revenue freight handled by "Class 1" railroads in the United States. The tonnage was made up as follows:

Total	100%
Agricultural crops and products	9
Animals and products	2
Coal and other minerals	54
Products of forests	8
Manufactures and miscellaneous	24
Merchandise (less than carlots)	3

The products of mines—coal, iron, oil, and copper—play a very large part in the freight business of the country (over 50% of the total). The origin of these products is fixed by nature so that if they are to be used, people must either move to the source of supply or else the materials must be transported to the market.

Similarly, many of the agricultural products, which comprise 11% of total tonnage, are highly centralized in production. For example, spring wheat and flax grow in the North, corn in the Central States, and cotton in the South. These crops and their products must be transported from one crop belt to another if they are to be generally consumed.

Of the total annual tonnage of freight moving on railroads and waterways in the United States in 1925, ocean ports handled 302 millions (Atlantic 172, Pacific 78, Gulf 52), inland waterways 334 millions (Great Lakes 130, rivers 204), and the railways 1,351 millions.

The total railway freight charges for 1928 were over $4,680,000,000. This is equal to approximately 45% of the farm value of all agricultural crops. It is about 17% of the value added by all manufacturing industries. Thus, rail transportation is seen to be a very important and costly social activity.

Flow of Traffic to and from the Central Northwest.—The Ninth Federal Reserve District, comprising Minnesota, the Dakotas, Montana, and small parts of Iowa, Wisconsin, and Michigan, contains 4% of the population of continental United States. Within this territory, which is 10% of the area of the United States, there are produced the following raw materials:

	Of the United States total
Durum wheat	100%
Flax	97
Iron ore	85
Manganese	80
Rye	54
Barley	47
All wheat	31
Oats	25
Linseed oil	25
Copper	25
Silver	25
Wood pulp	20

These basic materials, and the articles made from them, cannot all be consumed by the 4% of population which occupies the district. Their continued production is dependent upon transportation, for, in the last analysis, their production costs plus transportation charges to centers of consumption must be less here than elsewhere if production is to continue.

On the other hand, sugar is not produced in the Central Northwest in quantities equal to consumption; consequently, sugar prices here are New York or Philadelphia prices plus freight charges. The potato land of Minnesota can produce sugar beets in larger quantities than at present. But even with a freight rate of 63 cents per hundred pounds,[5] which it costs to bring in sugar from these eastern producing regions, farmers have so far found it more profitable to grow potatoes for sale and have sugar shipped into the district, than to grow sugar beets.

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[5] Freight rate on sugar from New York or Philadelphia to Minneapolis.

Transportation a Phase of Division of Labor.—Thus, it is seen that transportation is a phase of the division of labor. It presupposes the production of raw materials in one place, the conversion of raw materials into goods in a second place, and the consumption of these goods in still other places. The extent to which production becomes localized will, in a large measure, determine the future of transportation.

Consumption takes place in centers of population; centers of population are, in turn, due mainly to the concentration and growth of industry. In the United States, and probably in North America generally, the center of population is moving westward. For nearly all purposes, however, it is of little significance to refer to *a* center of population for a country. It is of importance, rather, to note that large industrial centers are developing in *various parts* of the country. To these centers both raw materials and foodstuffs must be shipped, and from these centers manufactured articles will be distributed.

Transportation and Location of Industry.—The specific location of industrial centers and the concentration of some industries in a limited number of locations have been associated closely with transportation development. In some instances, cities have grown because of strategic transportation facilities connecting them with market areas. In other cases, transportation facilities have grown with industrial development. Some of the important factors influencing localization of industry may be mentioned to explain partially the existing transportation network and to give some suggestion of future developments.

LOCATION DUE TO HISTORIC CAUSES. The present location of some industrial centers in the United States can be explained only on the grounds of historic expediency or accident. The early settlements were along the Atlantic seaboard and for a time the only consuming centers were located there. The iron and steel industry at one time was concentrated in

Massachusetts, mainly because there were neither markets nor labor elsewhere. During the years of westward migration and penetration into the continent, the western communities were busy breaking land, felling forests, and capturing the raw products from a pioneer region. During these years, manufacturing developed in the more populous, better organized East. Moreover, immigrant labor has always arrived mainly at the Atlantic ports. Since, as Adam Smith once said, "of all luggage, man is the hardest to move," this geographic accident has tended to localize industries requiring cheap labor in the Atlantic coast states.

Transportation facilities were developed accordingly, to perform the double function of moving the surplus primary materials from the frontier to the industrial centers and to return a part of the manufactured goods in exchange. These aspects of human geography explain, at least in part, the predominance of east and west transportation facilities at the close of the nineteenth century.

Another of the historic causes of localization of industry is found in the dominance of individual operators in the field. For example, Samuel Slater of Pawtucket, Rhode Island, is said to have trained practically every man who started a cotton mill in New England between 1790 and 1814; had such an outstanding personality happened to undertake his operations in the South, the history of cotton mills might have been very different, in which case the New England railroads would never have become so powerful. As another illustration, Ransom E. Olds established the first large automobile factory in America at Detroit because he was aided financially by several retired business friends residing in that city. The men whom Olds trained in the early days of the industry included many of the now famous automobile manufacturers. Thus the localization of the automobile industry and the large amount of rail transportation which it has developed are the results, in part, of the fact that certain men lived in a certain town.

In the early history of this country all industry was of the local type, such as the sawmills and grist mills. In those days there were no transportation facilities, and consequently each locality had to be self-sufficing. This early experience gave to certain communities the advantage of an early start in the production of some commodities which the rest of the country had to go without. As the railroad network developed, part of the strategy in arranging freight rates was designed to maintain and foster localized industry. The production of some commodities in one locality and different commodities in other localities was encouraged by so establishing freight rates that goods would be exchanged and freight traffic developed in both directions. Long hauls were given preference over short hauls, and advantages were given to the eastern seaboard cities on manufactured items, to prevent the development of manufacturing in the western agricultural regions. The result was a long haul of agricultural, mineral, and forestry products eastward from the frontier and a corresponding return haul of manufactured goods from the industrial East.

Power in Relation to Development of Industry. Power is an important determinant in the location of industrial centers. Pittsburgh was built up as the controlling steel producing point partly because it was cheaper to transport iron to coal than coal to iron. New England developed into its strong industrial position partly because of its cheap water-power, brought about by the happy combination of ample water with good velocity.

Cheap power is, however, much less highly concentrated geographically than was once supposed. The development of the oil resources of the extreme West and of the western half of the South gives opportunity for competition with the East and South. Then, too, electrical power may be developed in enormous quantity on the Pacific Coast and in the inter-mountain region, which is of particular importance following the perfection of steel manufacture with the electric blast furnace.

Development of Industry Near Primary Materials. There is often a tendency for industry to develop near the source of primary materials. The production of these materials is, itself, rather highly localized. Minerals are produced only where they have been deposited through the ages, while agricultural areas tend to specialize and to concentrate on the crops which each area can best produce. Thus copper mines are in Michigan and in the arid West, while iron mines are in Minnesota, Alabama, and Colorado; the spring wheat belt extends across the northern tier of states, with the corn and hog belt south of it, and the cotton belt still further south. The industries of smelting, flour milling, and hog packing have shown a tendency to develop close to those regions which produce their primary materials. Many other industries show similar tendencies.

In the case of steel, Cleveland, Gary, Duluth, and South Chicago are encroaching on Pittsburgh's primacy partly because they are near the raw material, and despite their distance from coal fields. Further, Birmingham is now producing almost half of the steel required by the South. Similar movements are to be observed elsewhere. Colorado and Utah are producing a part of the steel products for the inter-mountain district. This is of particular importance because of the "back-haul" freight policy that has so handicapped this territory in competition with other parts of the country. The Pittsburgh basing-point system has long been ignored in pricing Colorado steel products, so that the proximity to raw material is a real advantage to the consumer. A more complete self-support and less dependence on shipments from eastern centers is the result.

There are many other illustrations: the corn belt, where hides and leather are produced, is now the world's greatest shoe manufacturing center, having replaced New England in that particular. The cotton mills of the South are pressing hard upon New England mills, having consumed more cotton than the New England mills each year since 1913—in 1925, 2½ times as much. Portland cement plants are located where there is a supply of limestone of proper purity, generally accompanied by deposits of the right quality of clay. Canneries are nearly always found in the midst of the area where the raw materials are grown.

As this tendency increases, the transportation of raw materials will diminish. If the tendency continues to be accompanied by specialization by areas in the production of raw materials, transportation of finished goods will increase to take care of the requirements of consumers. This appears actually to be taking place, for during the fifteen years from 1913 to 1928 manufactured goods increased from 17% to 24% of the total tonnage hauled by railroads in the United States.

In some cases only part of the crude material is utilized in the finished product. When this is so, there is special argument for location of industry near the source of raw material, thus eliminating the transportation of the inert or waste material. There is often considerable saving, for example, in smelting low-grade ores at the mine.

In the flour milling industry, on the other hand, the case appears to be different. The part of the wheat which does not go into flour has a value as feed. In recent years the opportunity to dispose of mill feeds has been better in the market surrounding Buffalo than it has nearer the wheat fields. This is one of the important reasons for the development of a considerable milling industry at Buffalo, with transportation of wheat to that point.

There are other reasons which prevent location of industrial centers near the source of raw materials in some instances. For example, the South is handicapped in relation to the cotton industry by a social condition connected with the negro problem, which may never be overcome completely. Similarly, it is difficult to make any mining district as desirable a place to live as other localities. Moreover, when two or more primary materials are required in a process, as is often the case, it may be economical to establish the industry at a consuming center somewhere between the two.

Development of Industry Near the Consuming Market. "It has been true at all times that the factory nearest to the market for its product has had advantages over all others at a distance. Intimate acquaintance with the needs of the market, sensitive reaction to the whims of that market, quick response to emergency demands, and lowest carriage charges on goods, all have favored the factory which is in close contact with consumers of its goods. These advantages have been sacrificed in the past only because they were overshadowed by the necessity to be near raw materials, power or fuel, or because localized skilled labor was vital to production. With the decline in the importance of these factors, the economies of a location in easy touch with the market have been stressed.

"For many manufactured wares the market is the nation. Therefore, to keep in touch with the market requires manufacturers either to locate close to the center of population, or to divide the nation into natural districts, each of them served by its own manufacturing plants. Both of these policies tend to decentralize industry.

"The division of the nation into districts, each with its own manufacturing, is taking place right now. The oldest manufacturing area, New England, that once served all the nation, has organized a New England Council, one of whose purposes has been to promote sales of New England products within New England. The militantly self-conscious Pacific Coast is valiantly endeavoring to establish its own manufactures so as to shake off dependence upon the East and to relieve itself of high carriage charges upon manufactured articles. Likewise, the aroused South has begun an industrial campaign to balance its extractive industries. The Middle West undertook its own manufactures almost as soon as settlement was assured and has progressed so far that Ohio closely resembles Massachusetts in its degree of manufacturing, but is more fortunate in the possession of extractive industries.

"There have been attempts to combine large-scale industry and even localized manufacture with decentralization of plants near to the final consumer. The manufacture of Ford cars is a case in point. The principal plant, of course, is at Detroit, but all the large distributing centers have assembling plants of considerable size. These plants also manufacture some small parts and do much repairing on cars already sold. This scheme admits of large-scale production of the principal parts of the car at Detroit, with cheaper shipment in the knockdown state to the sub-manufacturing units, and then the assembling and final shipment to the consumer from these units.

"Although the pull of the market has influenced the location of all manufacturing, the magnetic effect of the market has been impressive in certain industries and has affected their localization. A case in point is the manufacture of agricultural tools and machinery. In the rush of planting or harvest, farmers cannot wait for repair parts to be sent from distant factories, and, moreover, agricultural machinery is expensive to ship. Accordingly, the railroad journey is cut to a minimum by placing the agricultural machinery mills near the fields. Once the industry was localized along the Atlantic; then it migrated with farmers to interior New York; later it became centered at Chicago, where there was easy access to all the great agricultural states of the upper Mississippi Valley. As farmers are also the most numerous purchasers of automobiles, the Detroit localization of the automobile business is advantageous in reaching its main market. Cotton textile machinery is manufactured in New England because that section long led in cotton manufacture. Steel manufacturers, being the greatest consumers of coke, determine the localization of modern by-product coke ovens."[6]

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[6] M. Keir, *Industries of America—Manufacturing*, pp. 124-125.

The factors which are important above all others in bringing about the decentralization of industry are human factors. The entire country is filling up with people; people who are consumers and who thus provide markets everywhere; people with various skills, training, and ambitions and who thus are able to undertake any and every sort of industry everywhere. These conditions reduce the local and traditional advantages of manufacturing in specialized areas, and they tend to limit transportation to those things concerning which localities have an advantage based on geology or climate.

Freight Rates and Location of Industry.—For the past hundred years the movement of freight has been from an established community in the East to a pioneer territory in the West. Bulky, raw materials have been carried to the East; valuable finished products have been distributed westward. Now the western frontier is about to disappear and many transportation changes will result. Distinct regional differences in economic development are fading. Ohio, Illinois, and Michigan have attained a balance between extractive and manufacturing industries which closely approaches regional self-sufficiency. Other districts show similar developments.

Among the forces which are compelling a similar balance in industries in other regions is the increase in railroad rates since the World War. These increased rates have caused manufacturers to scrutinize their position in relation to markets and raw materials. Out of their studies has come a distinct movement toward decentralization. This does not mean that old locations have been abandoned, but that expansions have been planned for new centers at some point advantageously situated between raw materials and market. These plans have the effect of spreading industry more evenly throughout the settled parts of the nation rather than concentrating them in the northeast corner. A further factor in the relocation of industry is the change in relative transportation costs between areas, brought about by new transportation routes, such as the Panama Canal, and new methods, such as trucking.

INFLUENCE OF FREIGHT RATE STRUCTURE ON INDUSTRY. As already suggested, New England held her preeminence as a manufacturing center for many years with the aid of a favorable rate structure. The flour milling industry in the Twin Cities owes part of its development to a similar circumstance. The traditional railroad policy was to charge what the traffic will bear. As suggested above, railroads often interpreted this point to the advantage of one community against competing communities.

More recently, freight rates have been regulated by presumably impartial tribunals, with a view to uniformity in competitive opportunity.[7] When rates are readjusted, however, the resulting tendency is to disorganize the economic structure. Under the old régime the railroads purposely disorganized conditions in keeping with some preconceived plan; under the present system the disorganization is unintentional and therefore haphazard.

Freight rate changes do not result in the same distribution of the freight burden as existed before the change for at least two reasons:

1. Different industries are always affected to varying degrees by the conditions which have led up to the change in freight rates. For this reason, although the original rate may have been based on an equitable distribution of the burden, the increased rate may be exorbitant in some instances. Most agricultural products fell in price more rapidly during 1919–1920 than did other commodities, and a correspondingly heavy load was, therefore, placed upon them by the freight advance of August, 1920. This is, however, a matter of constantly shifting ground; if it were considered in the adjustment of freight rates it might lead to endless changes of schedule.

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[7] The Interstate Commerce Commission regulates interstate rates, while separate commissions in each state regulate the intrastate rates.

2. Freight charges represent different proportions of the total cost of various commodities. Obviously, any change in freight rates will more noticeably affect supply prices in the case of products where freight is a large element of cost than where it is a small item.

The second point may be illustrated by the effect of the two post-war changes in freight rate charges upon two specific products which are shipped east from California in large annual volume, namely, citrus fruits and dried beans. The rate changes which were ordered in 1918[8] and 1920[9] by the Interstate Commerce Commission granted equal percentage increases for all commodities, totaling 67% of the previous rate. This, in effect, increased the delivered cost of all commodities moved by rail, but in varying degrees. The importance of the change depended, in large part, upon the relation between freight charges and total cost; in the case of citrus fruits, freight charges before the changes represented nearly 35% of the delivered price, as against 15% for beans.

In the case of beans the *increased* freight charge amounted to about 11% of the former delivered price, while with citrus fruits it was nearly 25%. This change may be strikingly presented as a comparison of the increased charge per acre of crop. On this basis, the bean crop had to pay $6.40 per acre more for freight than formerly, while the citrus industry paid an additional $149 per acre.

The selling price of an acre of bearing citrus orchard so greatly exceeds that of an acre of bean land that a fairer comparison may be made on the basis of freight charged for each $100 capital invested in the enterprise prior to the advances. Such comparison is as follows:

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[8] General Order No. 28, Director General of Railroads, June 15, 1918, horizontal Increase of 25% in Rates Made Effective. 15th Sec. application, No. 324, January 21, 1918, 45 I. C. C. 79. "Transcontinental commodity rates."

[9] August 26, 1920. Ex Parte 74. 58. I. C. C. 220. "Increased Rates 1920. Horizontal Increase 33 1/3% in all Rates Effective."

FREIGHT ON PRODUCT FOR EACH $100 INVESTED AT TIME OF POST-WAR FREIGHT RATE INCREASE

	Beans	Citrus Fruits
Rate prior to 1918	$4.50	$19.10
Increase of June, 1918, and August, 1920	3.20	13.55
Total after August, 1920	$7.70	$32.65

If the citrus grower were to pay the freight, his total costs would be increased by $13.55 for every $100 of investment, or 4¼ times as much as the increase to the bean grower. The 3.2% on investment absorbed by the increased freight in the case of beans, would take nearly all the net return which any agricultural enterprise earns on the average; the 13.5% on investment taken by the increased freight on citrus fruit is more than any agricultural product can stand without an offsetting increase in price. If the entire change in freight charge was passed on to the consumer, on the other hand, the wholesale price of citrus fruit would have increased nearly 25%, while that of beans would have been raised only 11%. The increase in freight rates thus lacked uniformity of effect on different commodities; it tended to decrease the acreage of citrus fruits more than it did that devoted to beans.

Many cases of unequal influence of freight changes on competitors might be cited. So many were brought to the attention of the Interstate Commerce Commission after 1920 that several adjustments in specific rates were made. It is an extremely difficult and complicated problem to handle, but if "uniform" freight rate changes are intended to maintain the existing equilibrium between commodities and localities, then the "uniformity" must be proportional to the relative part which freight charges play in total delivered costs. Otherwise the relative costs of commodities will be shifted with every change in freight rates and the equilibrium of supply and demand will constantly need to be reestablished. This, in time, will lead to a shift in the location of industries, at least in cases where transportation costs are an important item in delivered prices.

Present Demands on Transportation.—Modern methods of merchandising are placing heavier demands upon transportation facilities. For example, national advertising, when not accompanied by decentralized manufacturing, calls for transcontinental shipment of many branded commodities. If the residents of Minneapolis were all content to consume the clothing, cigars, tooth paste, and what not, manufactured there, freight and express facilities would not be required to bring the products of a score of competing manufacturers to the city. As it is, goods manufactured in one city are shipped to a dozen other cities from which nearly identical, competing goods are shipped in return.

Moreover, a growing emphasis is laid upon speed, both because of the increasing movement of perishable commodities and because of the growing emphasis on rate of stock-turn in merchandising.

Finally, with the tendency toward regional self-sufficiency which is perceptible, there is a strong urge to obtain transportation at a lower cost. This is evidenced especially by the established industries in their attempt to maintain their dominant position. The railroads are, themselves, vitally concerned in this, for, as already pointed out, complete decentralization means a great reduction in transportation.

Special Transportation Features.—To meet the growing pressure, transportation agencies—especially railroads—have developed a number of special features. Some of these consist of new types of equipment, while others are matters of service.

Refrigerator cars are an outstanding example of special equipment. Such cars are used to ship perishable commodities, such as animal products, fruits, and vegetables. The cars are kept cold by icing during the summer, and they may be heated during the winter.

Glass-lined cars are available for the shipment of perishable liquids, especially cream. Regular shipments of cream in cars of this type are made from Minnesota to New York and occasionally to Florida. The cars are so constructed that they may be thoroughly sterilized with steam.

Container cars are another illustration of new equipment. These are cars which are fitted with several large containers which may be packed with small package goods at the store or factory and then loaded and clamped onto the cars. They permit shippers to forward miscellaneous lots of goods without separate packages or containers, at rates between L.C.L. and carlot rates. The principal users of container car equipment have been the so-called freight-forwarding or consolidating companies. These companies have been engaged for a number of years in bulking merchandise shipments and thereby passing on to individual shippers a portion of the difference between carlot rates and the less-than-carlot rates.

Consolidated cars are frequently used to combine the shipments of several *sellers,* all going to one destination. This is generally accomplished through a shipping agency, although a number of farmers may combine to ship their hogs in carlots to the stockyards. Here, again, the saving is the difference between carlot and L.C.L. freight rates, which generally is a substantial amount. If different sorts of commodities are combined in one carload, the entire car takes the carlot rate of the commodity with the highest rate.

"Pool" cars are much the same as "consolidated" cars, except that the term is generally reserved for the combining of a group of orders by *purchasers.* That is, a number of retailers may pool their orders from a manufacturer and have a carlot of goods sent to one central address from which it is distributed. Some of the combined orders may come from

small towns near a central market in which case the shipment carries carlot rates to the central market where the carload is broken, and L.C.L. rates from there to destination.

Both consolidated and pool cars move through to destination without "breaking bulk" en route. Frequently they move in special fast freight trains.

Fast freight service has been in use for some years in the movement of perishables. Through freight trains are run on regular schedules, and almost as fast as are passenger trains. More recently, fast freight service has been extended to the movement of non-perishable commodities between the principal cities. This fast freight service is a supplement to express and parcel post service. To be fully effective, fast freight service must include facilities for rapid loading and unloading at the terminals.

On long hauls the privilege is often given of changing the destination of a freight car from the one named at time of shipment to one further along the line of traffic. This is called *reconsignment* or *diversion in transit.* Many carloads of perishable products are shipped from the Pacific Coast, for example, before they are sold. In such cases the goods are consigned to the shipper himself at one of the central markets such as Chicago, Minneapolis, or Omaha. If the car is sold before reaching that point, it is reconsigned to the purchaser at his receiving point. If it is still unsold on arrival at the original destination, it may either be turned over to a commission man there, or it may be "diverted" to any point further on without paying the local rate between the two points. The privilege is especially valuable for commodities which have a uniform freight rate to a large territory as, for example, western fruit, the rate on which is the same to all points east of the Mississippi. This privilege permits the shipper to decide the most profitable market for a particular carload several days later than would be necessary if diversion were not possible.

Transiting, through or "processing" rates are granted for commodities which it is desirable to process or store en route to their destination. For example, wheat may be shipped from the country point to a milling center, where it is ground into flour, and then be reshipped to a consuming market, under one freight rate. This rate is slightly higher than the rate from the country point direct to the final consuming market, but it is not nearly so high as the sum of the two separate rates. In a similar manner, cotton may be unloaded at specified cities for "classing" or grading; if destined for export, it may first be sent to a warehouse equipped with a high compression press; if purchased at a country point by a New England mill, it may be sent to a southern concentration city for temporary warehousing, to be forwarded later to the mill; in each of these cases, the freight rates in and outbound, combined, are but little more than the through rate direct to the final destination. Fruits, vegetables, butter, and eggs may be placed in cold storage in some city, later to be sent on to a more distant market, under the same sort of arrangement. Western wool is stopped for scouring and grading at St. Louis or Chicago en route to eastern markets, and for this privilege a charge of 3 cents a hundred pounds is added to the direct rate.

In each of these and similar cases the railroads have named certain cities as concentration or processing points. As a result, these cities tend to become central markets for the particular commodity, since buyers congregate wherever products are concentrated.

Each of these special services is instrumental in keeping the United States as a single, united, economic unit, in which the residents of any section can obtain the products of every other section. This situation gives the consumers in the different areas opportunity to obtain whatever is in vogue anywhere in the country. It also makes available to manufacturers the large volume of consumption which has made mass production, with its attendent economies, a reality.

Transportation and the Shipper.—Transportation is an important part of marketing; often it amounts to 10%, 25%, or even more, of the total cost of commodities. Moreover, it is a highly technical part of marketing; choice of economical routings, methods of packaging, avoidance of demurrage charges, all involve careful interpretation of complicated freight schedules and regulations. Finally, it directly influences the performance of the other marketing functions; decisions regarding the assembly of goods are sound only when transportation costs are considered, the place and time of storage may be determined by transportation facilities, and the risk involved in production of goods for sale may be lessened when the shipper is fully aware of all the transportation opportunities.

As a result of the importance and technical nature of transportation problems, most large shippers—whether buyers or sellers—have organized traffic departments. These departments determine the choice of carrier and the routings which give the most satisfactory and economical delivery of goods. They supervise the packaging and loading according to the carriers' specifications and in such a manner that each shipment takes the lowest possible freight rate; they also audit the freight bills. They keep track of each shipment from origin to destination, to see that the carrier lives up to its contract. In case of any failure on the part of the carrier to give satisfactory service, the traffic department undertakes to establish the amount of resulting damage. It then either places a claim for loss, damage, and delay with the carrier, or, if necessary, hands the facts to the legal department for action.

Thus a traffic department is a valuable part of any marketing institution. It is often able to save large sums for the shipper, through an adequate understanding of the problems involved in traffic and a careful planning of the operations involved.

City Transportation.—This chapter has dealt with the movement of commodities from one area to another. There is also a series of problems connected with the distribution of goods within our cities. These problems fall into two main groups, namely, (1) the wholesale receipt of commodities and their distribution to manufacturers and the retail outlets, and (2) the problems of city retail shopping. The wholesale problems are complicated because many cities serve as concentration points, in which supplies are collected to be reshipped later to surrounding smaller cities and towns. The part played in commodity distribution by strategically located cities, together with some of the physical problems of retail distribution, will be discussed in the following chapter.

International Transportation.—Areas of production and consumption do not necessarily follow national lines. A large volume of trade takes place internationally, i.e., between individuals located in different countries. There are many special problems connected with this international trade. These arise out of differences in consumers' habits, tariff regulations, joint rail and water transportation, and other causes. A fuller discussion of international trade is reserved for Chapter 17.

CHAPTER 16

METROPOLITAN AREAS AND CENTERS

Metropolitan Economy Defined.—As pointed out in the preceding chapter, there is a modern tendency toward decentralization of industry. In spite of this tendency, however, few communities become literally self-sufficing, or even closely approach that state. What is happening, apparently, is that more or less clearly defined economic areas are developing, with a metropolitan center as a nucleus for the trade and industrial life of the area. Within each area are towns and cities of many sizes, and a hinterland from which come supplies of primary materials. Each of these areas is tending toward self-sufficiency.

Within these areas the converging and diverging movements of goods take place. Raw materials from the hinterland are concentrated in the metropolitan center, either for proceessing, for city consumption, or for distribution to other centers and areas. As a result, the large central markets develop, such as the cash wheat markets in Minneapolis and Kansas City, the cotton markets in Memphis, Dallas, and New Orleans, the livestock markets in Chicago and St. Louis, and so on. Here, also, commodities not produced in sufficient quantity for consumption within the area are received, to be distributed to consumers throughout the area. Thus a social organization based upon exchange is developed, in which the cities act as processing and service centers in cooperation with the hinterland and its production of raw materials.

As Professor Gras has defined it, "metropolitan economy is the organization of producers and consumers mutually dependent for goods and services, wherein their wants are supplied by a system of exchanges concentrated in a large city which is the focus of local trade and the center through which normal economic relations with the outside are established and maintained.

"Just as villages remained when town economy prevailed, so do towns remain when metropolitan economy comes into existence. Towns remain, but in economic subordination to the metropolis. They continue to play a part, but as tributaries to a larger center. Towns exist, but not town economy. This change is marked by many a struggle as independent communities fell under the shadow—we can hardly say yoke—of the metropolitan center. Southampton and Bristol became subordinated to London; Rouen to Paris; Salem and Portland to Boston; Albany and Buffalo to New York; Milwaukee and Detroit to Chicago."[1]

The distribution of goods from the standpoint of the development of metropolitan areas, i.e., the economic areas surrounding the metropolitan centers, presents a different emphasis on the study of marketing from that found when either commodities or functions are the basis of study. In this line of approach the interest is centered primarily, not on the commodity, but on the interrelations worked out between groups of producers and consumers. Marketing, then, becomes the intimate concern of human beings who are interested in securing the greatest measure of satisfaction of their wants with the least possible effort; it becomes a phase of the larger problem of the means of satisfying human wants. Metropolitan areas, with their complex relationships, are part of the current economic machinery developed in the search for enhanced human satisfaction.[2]

Rapid Growth of Cities.—The rapid growth of cities has been one of the modern phenomena of United States development. The percentage of persons in urban population has increased steadily during recent decades. In 1890 it was 36%, in 1900 it was 40%, in 1910 it was 46%, and in 1920 it was 52%. In 1930 it will be nearly 60%. The number of cities with over 100,000 population and over 500,000 population respectively at succeeding decades is given in the following table:

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[1] N. S. B. Gras, *An Introduction to Economic History*, p. 186.

[2] The Department of Commerce is conducting a series of studies of metropolitan areas. Reports for the Philadelphia area, the Southeast, New England and the Pacific Southwest are available. Others are to follow.

GROWTH OF LARGE CITIES

Year	Number of Cities with Population	
	Over 100,000	Over 500,000
1860	8	2
1870	14	2
1880	19	3
1890	26	3
1900	36	6
1910	50	8
1920	68	12
1926	81	13

Two Explanations of City Development.—There are at least two principal explanations of this development:

1. There is a real increase in the productive output per person in agriculture. This change is due, in large measure, to the increasing use of machinery in place of hand tools, and the substitution of power—horse, hydraulic, wind, steam, gasoline, and electric power—for human labor. With this increasing output per man has come little increase in the per capita consumption of agricultural products, especially those which are used for food.

2. The other part of the explanation is that many operations previously performed by farmers are now carried out in the cities by workers in the manufacturing industries. Not so long ago, flour for home use was ground on the farm. Timber was cut, sawed, planed, and even made into furniture, by the farmer. Many farm implements were home-made. Dairy

products—butter, cheese, and so on—were farm products. Now all of these things are part of city industrial life.

As a result of these two phenomena, it is no longer possible for so large a proportion of the total population to find profitable occupation on the farms. The inevitable result has been the relative expansion of the cities.

Effect of City Growth on Marketing.—These social changes have definitely affected both city growth and marketing problems. The division of labor between the production and processing of materials has called forth increased marketing activity with primary materials, both in physical movement of goods to concentration points at terminal markets where they are processed, and in the change of ownership. It then becomes necessary to redistribute the processed articles from the manufacturing centers to the consumers. The greater the specialization in the extractive and manufacturing industries, the greater the relative importance of marketing, for with specialized industries goods are produced entirely for exchange.

Requirements of Cities.—In the main, modern cities have grown up where four characteristics are combined, namely: (1) a healthful place for people to live; (2) shipping facilities for the receipt of raw materials and redistribution of finished products; (3) location between groups of producers of basic materials and consumers of finished goods; and (4) a hinterland, or surrounding territory, that gives an immediate and proximate demand for the services which a city can provide.

Phases of Metropolitan Development.—As cities develop, they may exercise a growing influence upon all of the surrounding territory, attaching the territory to them as a metropolitan area. Generally, this influence first develops through the organization of *marketing* facilities. This is shortly followed by the development of *manufacturing* industries. In order adequately to perform the marketing and industrial obligations, the city becomes the center of a network of *transportation.*

And, finally, local *financial institutions* are so organized that the city may take care of the needs of the metropolitan area.

Each city is a nucleus around which many activities cluster. Frequently cities clearly divide into two supplementary phases or activities, namely, manufacturing and trade. "The creation of a market within a localized industry leads logically to the result that some portion of the community devotes itself more and more exclusively to the marketing side of the business. In England, Manchester is less a cotton-mill town than it is a warehouse city where raw materials are collected for the cotton mills in nearby Bolton or Oldham, or where the cloth from those mills is sold. Leeds holds a similar position in respect to the iron trade of England. In Massachusetts we see a like tendency in that Boston is the warehouse for the shoe industry on its border, and New Bedford is really three towns under one name, two devoted to manufacture and one to trade. Worcester holds an analogous position for the textile mills of the Blackstone River Valley, and Providence for the jewelry industry of the Attleboros. New York City is notable for the increase of its marketing function and the relative decrease of its manufacturing. What Brooklyn, the Jersey shore towns and nearby Connecticut cities are to New York so, too, the cities of Oakland, Berkeley, Richmond, and Alameda are becoming to San Francisco. The outlying places house the manufactures while the metropolis functions as a market and financial center for the peripheral factories.

"The cause for this striking segregation of the market is twofold; on the one hand, it is due to unusual transportation and financial facilities at one part of the district and, on the other, to the increasing rents at a center, driving factories to the rim and leaving the heart to offices which take up little space. These central places, too, offer advantages for buyers to congregate; aside from railway and hotel accommodations, it is easier for buyers to visit a series of warerooms close together than it is to travel from mill to mill, although the mills may all be in one district. Wherever an industry has become sufficiently developed in one locality to bring forth a central market for buying and selling, the advantages of the localization are greatly increased, since a well-defined place of bargain and sale secures more trade than would a number of scattered offices."[3]

Differences Between Cities.—While all cities exercise some influence upon the surrounding territory, by no means all cities reach the commanding position of a complete metropolitan center. There may be several populous cities within one metropolitan area, which specialize in industrial production, for example, without development of the marketing and banking facilities required by the surrounding territory. Detroit, Rochester, N. Y., and Birmingham, are cases in point. On the other hand, Los Angeles and Salt Lake City, until very recently at least, were serving mainly as centers for marketing, without the supplementary development of manufacturing.

Every city of considerable size distributes goods at wholesale to the surrounding territory. In some cases, the territory served is so large that the sales at wholesale from the city are materially larger than the retail sales within the city. The United States Department of Commerce has recently (1927) gathered data on both the wholesale and retail sales for several representative cities. The ratio between wholesale and retail sales varies considerably, as shown in the following table:

City	Ratio of Sales Wholesale to Retail
Kansas City	3.35 to 1
Atlanta	3.00 to 1
Chicago	2.45 to 1
Denver	2.15 to 1
Seattle	2.07 to 1
Baltimore	1.08 to 1

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[3] M. Keir, *Industries of America—Manufacturing,* p. 135.

In other words, Kansas City serves as wholesale center for a much wider territory than does Baltimore.

The Twin Cities as an Illustration of Metropolitan Development.—The history of the Twin Cities and surrounding territory affords an excellent illustration of the development of a metropolitan area. General figures for the production of leading raw materials in the northwest have been given in the preceding chapter. This specialized production calls forth not only transportation but other marketing activities.

DEVELOPMENT OF TRADE. In the early days, before 1850, St. Paul and the adjoining settlements were primarily trading posts. Manufactured foodstuffs, cloth, and other essentials were freighted up river to St. Paul where they were exchanged for furs. Then they were distributed to the surrounding territory. The wholesale receipt of commodities, accompanied by their storage and redistribution in smaller lots throughout the central northwest trade territory has remained, until very recently, the outstanding activity of St. Paul. Before 1890, St. Paul's wholesale trade had passed the $100,000,000 mark, and since then its growth has been steady, although not so rapid. In 1920, it laid claim to five lines of jobbing, each having annual sales of $5,000,000 to $50,000,000, and ten more of over $1,000,000 each. The jobbing interests of the Twin Cities combined have been easily double these figures from 1890 on.

The handling of grain has been one of the outstanding market developments in the Twin Cities. Between 1870 and 1880, wheat production in Minnesota almost doubled, but Minneapolis wheat receipts increased more rapidly than this, doubling in the four years from 1876 to 1880. By the latter date, Minneapolis was one of the ten leading terminal markets for wheat in the country.

During the earlier days, most of the wheat received was milled in the city, but later on large quantities were received, stored, and finally reshipped for milling elsewhere. The development of these two movements is shown by the following table:

RECEIPTS AND SHIPMENTS OF WHEAT AT MINNEAPOLIS

Year	Receipts (Bushels)	Shipments (Bushels)
1876	5,037,575	48,030
1880	10,264,100	133,600
1885	32,900,560	4,944,240
1890	45,271,910	12,173,395
1895	65,436,390	12,941,620
1900	83,312,320	10,937,010
1905	93,263,910	23,152,920
1910	99,721,600	19,207,130
1915	142,669,310	56,643,170
1920	112,366,000	46,288,940
1925	108,689,420	53,083,310

In order to accommodate the huge grain business, the elevator storage capacity has increased greatly. In 1879 it amounted to only 215,000 bushels; by 1925 it had exceeded 56,000,000 bushels, and Minneapolis was the largest primary grain market in the country.

The Minneapolis Chamber of Commerce, which has been described previously, was organized in 1881 to facilitate the handling of wheat and allied agricultural products.

The Twin Cities also have highly developed market organizations for others of the commodities produced within the metropolitan area. These include the livestock market associated with the packing plants in South St. Paul, public markets in each city for the distribution of local produce, the third largest butter market in the United States, the Twin City Milk Producers Association, with its 62,000 members, which delivers milk to local distributors, and so on.

DEVELOPMENT OF MANUFACTURING. The manufacturing supremacy of the Twin Cities was for many years based upon the output of flour and lumber, and the Northwest is still best known to the country at large for these products. Even as late as 1910, the United States Census showed that flour and grist mill products and lumber constituted practically half the total value of manufacturers.

Other lines, however, have become of considerable importance. The Twin Cities produce substantial amounts of the following commodities beyond the requirements of the metropolitan area: linseed oil, bags, furniture, road machinery, knit goods, leather and sheep-lined clothing, furniture, paints, and a number of specialties such as heating devices, electrical equipment, automotive supplies, and so on. There is also a substantial increase in the manufacture of cereal foods, biscuits, candy, cloth garments, and many other commodities consumed within the area.

This development of manufacturing is modifying the marketing problems. In part, the products are locally consumed; in such cases they enter retail trade channels quite directly. To a considerable extent, however, the manufactures of the Twin Cities area are specialties which are distributed more widely. These commodities require coordinated sales organizations to carry out the functions of exchange, and transportation facilities to give prompt and economical distribution to the other consuming centers.

DEVELOPMENT OF TRANSPORTATION. The Twin Cities were located at the head of the early river transportation. That gave them a commanding position with respect to the trade of the Northwest. In the early days, St. Paul was about the only entrepôt for the trade of the scattered settlements in all the regions west to the mountains and north to the Hudson Bay Company's posts. Originally most of the trade went down the river to St. Louis and thence to New Orleans. Some of it, however, went overland to Lake Michigan and thence east by lake or overland.

The development of rail transportation gave closer connection between the Twin Cities and Lake Michigan, especially at Chicago and Milwaukee (first accomplished in 1867). Rivalry of these two cities with St. Louis for the Twin Cities trade resulted favorably to the rail transportation. This was but part of the growing predominance of railroads from 1850 on, referred to in the preceding chapter.

As the railroad network developed throughout the Northwest, the Twin Cities held their strategic position, for all of the major roads entering the territory were routed through them. One significant change which came with the development of the all-rail routes to the East was that they made the Twin Cities an all-year market, not dependent upon the river except as it offered a cheaper alternative to railroad transportation.

As suggested in the previous chapter, the early freight rate schedules were often so arranged as to favor certain cities and trade routes as against others. It is impossible to go into details at this point, but there are clear evidences of the fact that rail rates to and from the Twin Cities, both to the eastern markets and into the west and northwest hinterland, tended to extend the influence of the urban center over the surrounding area.

For many years there was keen competition between the Twin Cities and Chicago for the trade of the Northwest, especially between wholesale distributors of commodities originating in the East. Rail connections with Duluth in 1872 and from there eastward by water did much to aid the Twin Cities in this competition. With the complete network of transportation facilities which has developed, the Twin Cities have maintained their position as a wholesale distributing point against Chicago competition.

Two things have occurred within the past few years, however, which have lessened the prestige of the Twin Cities as a wholesale center. In the first place, manufacturers are dealing directly with the retailers to a larger extent than formerly, which makes it unnecessary for goods to be stored and transshipped at any local point. In such cases, the Twin Cities are but a way station on the main line, rather than a load-breaking point. In the second place, the recent Fargo[4] and Watertown[5] rate cases have rearranged the local freight rates to an extent which permits wholesalers at Fargo and other western points to offer serious competition to Twin Cities dealers in much of the western part of the area. These decisions prohibited intra-state rates from Minneapolis to points within the state, which were substantially lower than interstate rates to the same points from equally close out-of-state centers, and also any combination of intra-state and interstate rates which would permit shipment from Minneapolis to Dakota or Iowa points at less than the established interstate rate. Thus an advantage to Twin Cities wholesalers was removed.

Transportation and merchandising arrangements are, therefore, combining to lessen the importance of the Twin Cities as a jobbing center.

GROWTH OF FINANCIAL INSTITUTIONS. The final stage of metropolitan development is said to come when (1) the financial assistance of the urban center is essential to the industries in the surrounding area, and (2) when the financial institutions in the city are adequate to supply the needs of the area.

In the early days of development of the Twin Cities, much financial aid from outside was obtained. The milling industry seems to have been financed in considerable part by British capital; the Hill interests in railroad development were supported by New York financiers, and so on. Gradually, however, the financial institutions of the Twin Cities took over an increasing part of the burden. Crop movements and other local requirements in the hinterland were provided for by the city banks. Finally, the location of the Federal Reserve Bank in Minneapolis and of the Federal Farm Loan Bank in St. Paul were striking endorsements of the Twin Cities as the financial center of a wide and matured metropolitan area. More recently, the Twin City Stock Exchange is a further manifestation. The financial preeminence of the Twin Cities is unqualified throughout this area.

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[4] Fargo Commercial Club *v.* A. & W. Ry. Co., 98 I. C. C. 691, June 2, 1925.

[5] Watertown Chamber of Commerce *v.* C. & N. W. *et al.*, 101 I. C. C. 427, November 18, 1925.

Thus, the Twin Cities have extended their dominance over a metropolitan area—an area which is roughly outlined by the boundaries of the Ninth Federal Reserve District. They are still the jobbing center of the Northwest, although their preeminence in that particular is not so great as it once was. Their prestige as a manufacturing center is increasing, especially as the result of diversification of industries. They are still the transportation gateway to the area, although Duluth is an important secondary point of entry. More recently they have assumed the responsibility of supplying the financial needs of their hinterland. The center could not have developed without the back country; it should continue to grow as activities in the surrounding area expand.

Marketing for a City's Industries.—As metropolitan areas grow older, manufacturing becomes more important in their economy. The problem of supplying industries with the required raw materials and other necessaries, and the equally important problem of choosing the channels through which the products of industry are to be distributed are of major importance in metropolitan economy.

The Department of Commerce has made a census of industrial purchases and distribution in Cleveland, Ohio, and its immediate environs. The survey shows in a general way the classes of materials which are purchased by the industries in Cleveland, as well as the channels employed in the distribution of finished products.

INDUSTRIAL PURCHASES—CUYAHOGA COUNTY (CLEVELAND AND ENVIRONS), OHIO, 1927

Industries	Total Purchases in Dollars	Percentage of Total Purchases			
		Raw Materials	Semi-Manufactured Products	Supplies, Fuel, Packing Materials	Equipment Maintenance, etc.
Chemicals and allied ind.	$ 48,343,000	50.49%	36.93%	9.62%	2.96%
Food and kindred products	71,816,000	68.27	24.54	5.34	1.85
Iron and steel industries	158,907,000	7.50	71.77	13.85	6.88
Lumber and allied products	7,925,000	*	90.89	5.39	3.72
Machinery (other than transportation equip.)	61,550,000	0.0	82.20	9.30	8.50
Metal and metal products (other than iron and steel)	20,633,000	0.0	90.52	6.06	3.42
Paper, printing, and related industries	15,318,000	0.0	84.08	5.56	10.36
Stone, clay, and glass products	2,639,000	36.82	12.91	38.28	11.99
Textiles and their products	43,061.000	8.48	87.55	2.38	1.59
Transportation equipment	91,220,000	0.0	94.24	2.95	2.81
Miscellaneous industries	12,839,000	13.46	72.10	9.04	5.40

* Combined with semi-manufactured products.

The purchases of raw materials are quite small, except in three industries. The purchases of semi-manufactured products, on the other hand, are important in all industries, sometimes representing 90% or more of all purchases. This indicates that the early stages of manufacture are performed outside the metropolitan center, probably nearer the source of the raw materials. Transportation and the other phases of marketing are affected accordingly.

Some of the goods produced in Cleveland are sold by the manufacturers to wholesalers, some to retailers, and some direct to consumers. The findings of the Department of Commerce on this point are given in the table on page 264.

In each of 5 industries, 45% or more of the products are sold by the manufacturer to the consumer. In these cases, the principal direct purchasers are other industrialists who use the goods as installation or accessory equipment, fabricating materials, or supplies; such purchasers generally make direct contact with manufacturers. Probably most of the direct sales in all the industries can be accounted for in this manner.

Sales by Manufacturers—Cuyahoga County (Cleveland and Environs), Ohio, 1927

Industries	Total Sales in Dollars	Percentage Sold Through Different Channels				
		Wholesaler Jobber	Chain or Voluntary chain	Independ't Retailer	Direct to Consumer	Manufacturer Unable to Classify Purchasers
Chemicals and allied ind....	$ 79,339,000	12.25%	0.0	5.88%	28.49%	53.38%
Food and kindred products.	99,232,000	17.92	*	56.06*	10.84	15.18
Iron and steel industries....	275,919,000	13.57	0.25	1.61	45.04	39.53
Lumber and allied products.	15,945,000	10.94	0.0	34.43	45.42	9.21
Machinery (other than transportation equip.)........	159,085,000	24.61	0.57	9.77	54.59	10.46
Metal and other products (other than iron and steel).	32,795,000	19.42	0.28	2.64	68.67	8.99
Paper, printing, and related industries..............	37,487,000	4.96	0.0	5.75	79.67	9.62
Stone, clay, and glass products..................	87,096,000	20.75	0.0	9.55	36.43	32.27
Textiles and their products..	82,521,000	15.75	21.75	47.23	13.40	1.87
Transportation equipment..	148,170,000	3.53	0.0	52.22	15.96	28.29
Miscellaneous industries....	29,715,000	39.18	1.11	11.22	31.94	16.55

* Includes sales to chains and voluntary chains.

The high percentage of sales to retailers by food and textile product manufacturers suggests a lessening in the importance of wholesalers in the distribution of consumer goods. Regional self-sufficiency, with the manufacturers and retailers geographically close together, may be expected to still further increase direct sales. Wholesalers are of especial importance when goods must be brought together from many sources, contact with which is difficult to make. As manufacturing increases within a metropolitan area it is probable, therefore, that the wholesale side of trade will become relatively less important.

The differences in each industry between the purchases and sales are distributed, in the main, between wages, rent, interest, and other overhead expenses. The sums so distributed range from $5,000,000 in the stone and glass products industries to $117,000,000 in the iron and steel industries. The total for the industries cited is approximately $433,000,000. To a considerable extent, this becomes part of the purchasing power of the residents of the community, for consumer goods.

Many other illustrations might be given of the trading relations in metropolitan areas. These two cases—the Twin Cities and the Cleveland areas—will serve to show some of the major developments. The wholesale and retail organizations within a metropolitan center have already been illustrated for the Twin Cities in Chapter 7.

Metropolitan Rivalry.—The rivalry between metropolitan centers has already been referred to. Chicago and St. Louis competed for the trade of the Twin Cities; the Twin Cities and Chicago were, and are, in direct competition for the northwest trade; Fargo and Watertown have recently succeeded in reducing the Twin Cities' supremacy as a jobbing center; in the same way, Aberdeen, Valley City, Minot, and Grand Forks may later supersede Fargo and Watertown, and so on. This same sort of rivalry is occurring throughout the civilized world. In its broadest aspects the rivalry between cities is well illustrated by the following diagram:[6]

DIAGRAM ILLUSTRATING METROPOLITAN RIVALRY

x Vancouver Victoria	*** Winnipeg**		*** Toronto**	*** Montreal**	*** Amsterdam**
	□ Duluth			*** Boston**	*** London**
x Seattle	*** Twin Cities**	*** Chicago**		*** New York**	
			*** Cleveland**		
	□ Omaha				
*** San Francisco**	*** Kansas City**	*** St. Louis**		*** Baltimore**	
			*** Cincinnati**		
*** Los Angeles**				*** New Orleans**	*** Paris**

LEGEND:

*** Stars are metropolitan centers.**
x Crosses are centers of metropolitan promise.
□ Squares are ambitious but subordinate cities.
Vertical lines, if drawn, would pass through centers of equal age.
Horizontal lines, if drawn, would pass through centers of unequal age.
No attempt has been made to show exact longitude or latitude.

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[6] N. S. B. Gras, *Introduction to Economic History,* p. 283.

Intra-Area Rivalry. Within the metropolitan area there is also considerable rivalry. The United States Department of Commerce has recently published an atlas of wholesale grocery territories (1927). One plate from that atlas is reproduced here, showing the division of trade territory lying between the two metropolitan centers, Chicago and the Twin Cities. While these lines are not as precise and clear-cut as the map suggests, they do set off practical working districts for the planning of wholesale distribution, not only for groceries but for other commodities as well.

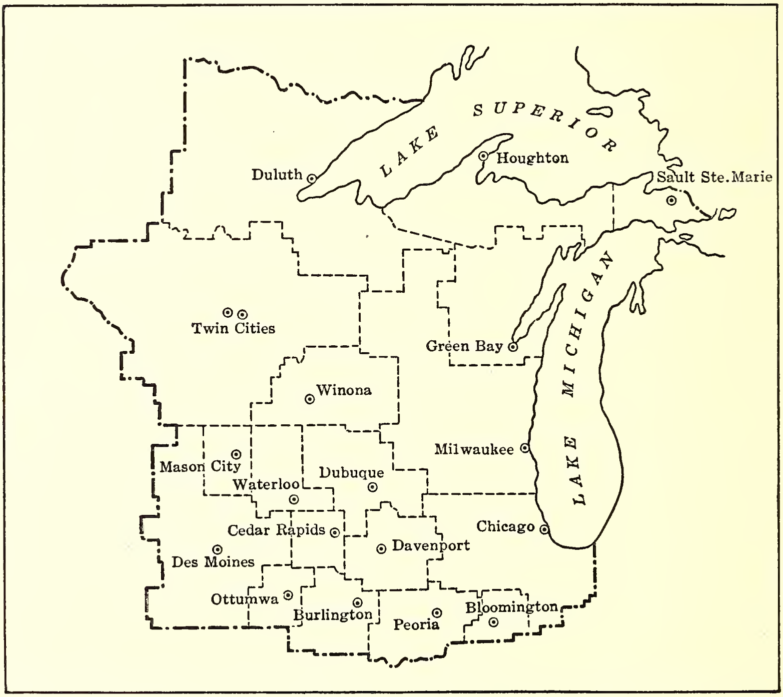
LAKE SUPERIOR
Houghton
Duluth
Sault Ste. Marie
LAKE MICHIGAN
Twin Cities
Green Bay
Winona
Milwaukee
Mason City
Dubuque
Waterloo
Cedar Rapids
Chicago
Davenport
Des Moines
Ottumwa
Burlington
Peoria
Bloomington

Figure 17. Wholesale Grocery Territories

Professor Secrist has studied intensively the interrelation and overlapping of trading in this same Twin Cities and Chicago area with reference to the retailing of men's clothing.[7] From this study the following conclusions seem clear:

1. Consumer purchasing in other than the city of residence is common, the direction of trade being generally from the small to the large cities.
2. Intercity trading is especially pronounced when there is (a) easy transportation between cities, (b) large automobile ownership, (c) intercity circulation of newspapers or other advertising mediums.
3. The larger the city of residence, the more common it is for men to buy their suits at home.

"Every city of appreciable size in the United States is a trading place for clothing. But these centers are not isolated and discontinuous. They are linked together by transportation facilities and by advertised news of trading opportunities. They are not all competing, but competition is everywhere present, transmitted as it is through the medium of intercity trade."[8]

This continuous chain of competition automatically results in definite price alignment between markets. This fact has already been emphasized, especially in regard to prices of primary materials. It is equally true with respect to consumer goods; where artificial trade barriers do not exist, prices tend to be linked together in a logical and predictable manner. Certainly this applies throughout each metropolitan area.

Inter-Area Trade.—In spite of any tendencies toward self-sufficiency of metropolitan areas, there remains a large volume of traffic between areas. This is clearly illustrated by the following graph of the intersectional trade of the Pacific Southwest. Data for other regions show equally important inter-area movements.

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[7] Horace Secrist, *The Widening Retail Market.*
[8] *Ibid.*, p. 115.

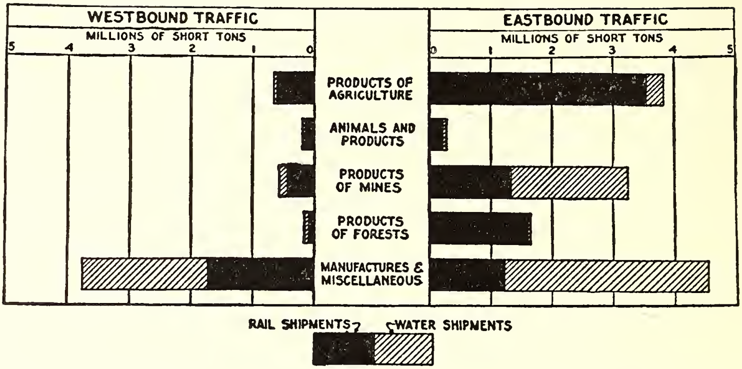

Figure 18. Transcontinental and Intercoastal Trade of the Pacific Southwest—Leading Groups of Commodities, 1926 (U. S. Dept. of Commerce. Domestic Commerce, No. 25, p. 5)

Several points may be made in connection with the trade of the Southwest: (1) The outgoing traffic in crude materials is relatively heavy, indicating that the territory is still somewhat in the pioneer stage, and that metropolitan economy has not matured to the point where local industries fully utilize locally produced primary materials. (2) Products of agriculture and of forests are sent to every state in the union. Individual products are limited in their distribution, however. For instance, wool is shipped mainly to New England, and hides to a few tanning centers, because of the localization of the industries which process these primary materials. On the other hand, flour is sent largely to New York, and hay to Texas and Missouri, because those are the principal consuming markets with deficient local supplies.

Intra-City Development and Problems.—As cities grow larger, many complications of trade develop. Traffic congestion, delays in delivery, impersonal service in huge retail establishments, crowded conditions for shopping—these all are conducive to the establishment of local shopping districts throughout the city. In the case of stores handling convenience goods, such as groceries and drugs, a high degree of decentralization has developed. With other types of stores, such as those handling shoes, furniture, dry goods, and so on, concentrated subshopping areas develop at strategic points along main avenues of traffic. Congestion and delay also occur in the wholesale markets especially in cities like Chicago, Kansas City, the Twin Cities, and others, where much merchandise is received for subsequent reshipment throughout the metropolitan area.

Terminals and Marketing.—The movement of goods through transportation terminals adds an important part to the costs of distribution. Cities have grown so rapidly that facilities which seemed adequate when originally planned and built have become crowded, wrongly located, and generally inefficient. Moreover, as new transportation agencies have entered a city, they have frequently duplicated terminals, thus causing waste in transfer between them. In some instances, this has led to the location of central markets near one terminal, but at considerable distance from others within the same city. For example, the New York citrus fruit auction for many years was accessible only from the Erie railroad; the Minneapolis fruit and vegetable auction is on the Chicago, Milwaukee, St. Paul, and Pacific, but is not reached directly by other roads; and so on. Both in Boston and in Chicago, much produce must be hauled by wagon or truck, through busy city streets, from the terminals to the central markets. In Boston this problem has become so acute and the traffic congestion so serious that such hauling is limited to certain night and early morning hours.

These conditions cause added expense in handling, both intra-terminal and between the terminals. Moreover, the delay resulting from these cumbersome arrangements makes it necessary for distributors to carry larger reserve stocks than if shipments moved more quickly, thus increasing interest, storage, and risk costs. Especially in the case of perishables, delay often results in loss through deterioration and spoilage.

To overcome this situation, many cities are developing beltline transportation systems around or through the city, connecting all terminals and all important industries and markets. As these systems are perfected, much of the delay and extra handling is avoided. This is a large undertaking, however, involving heavy capital expenditure and long-time forecasting of city development. Few cities, if any, have adequately met the situation.

The fast freight schedules, container-car equipment, and other special services described in the preceding chapter, lose much of their value unless terminal facilities are adequate to handle all transfers and receipts promptly. The railroads are attempting to cope with this problem by providing special freight trains devoted to L.C.L. or "package" freight; an average of 3,000 cars leave Chicago daily in such trains, for 1,800 destinations.

The railroads are undertaking, also, to speed up the handling of L.C.L. freight, both intra-terminal and between terminals, by the use of motor trucks. Formerly, package freight for forwarding was loaded into cars at each terminal. Many of these cars were later shunted to other terminals, either to be filled for shipment, or more often to have their packages resorted for loading into cars with the proper destination. Transfer by this method seldom took less than 24 hours, and often longer, while the same operation can be accomplished through motor transfer in an hour or less. The same situation existed with respect to shipments requiring transfer from one carrier to another in any large city transfer point. For example, under the old system, if a car of L.C.L. freight were dispatched from Red Wing to St. Paul on the Chicago, Milwaukee, St. Paul, and Pacific, on a Monday, it would arrive in the Milwaukee yards in St. Paul the next day. The following day, Wednesday, it would be shifted several miles to the Minnesota Transfer, with possibly only a few hundred pounds of freight aboard, destined for some point on the Rock Island system. On Thursday, the car would be pulled to the Rock Island yards, where the actual transfer would be made, 48 hours or more after the original arrival of the goods in St. Paul. Yet, the Milwaukee and Rock Island freight houses have only the Robert Street bridge in St. Paul between them, and the transfer could have been made by motor truck in an hour's time. Seven of the nine principal railroads entering the Twin Cities are now making all of their L.C.L. transfers with the aid of motor trucks, thus economizing on time, cars, trackage, and expense.

The Cities-within-the-City.—Especially from the standpoint of retail trade, a city the size of Chicago is in reality many cities. The General Outdoor Advertising Company has published a chart, dividing Chicago into 21 cities-within-the-city, and giving pertinent data regarding each district. For example, District "A" is a strip a mile wide paralleling the lake shore, from the northern end of Lincoln Park to the city limits. The following data refer to this district:

DISTRICT A:

Population	142,885
Number of families	34,850
Number of groceries and delicatessens	533
Number of drug stores	166
Number of hardware stores	93
Number of banks	14

The population immediately surrounding the trading center lives for the most part in high-class rooming houses, kitchenette apartments, and hotels. The area north and south is populated by a class of people ranging from the better class to the middle class from a buying standpoint. The predominating nationality of the district is American.

Similar data are given for each of the 21 districts. The situation here depicted is typical of any large city. It illustrates the complexity of the existing organization for retailing.

Such studies are important in the planning of retail distribution. The manufacturer's market research must include a careful study of each district and its shopping center if he is to choose wisely the outlets through which to sell. In many cases, a district is populated by certain income groups only, or predominantly by one racial or occupational group, which fact may affect its usefulness as a distributing center for individual commodities. In other cases, the parking facilities or other features of accessibility will make one shopping center a better outlet than another with similar surrounding population. A recent study in Los Angeles showed, for example, that many people go several miles by automobile to shop in Beverly Hills, because of the congested condition of the central shopping area in Los Angeles, the comparative ease of parking in the outlying district, and the class of people who live in Beverly Hills.

Vehicular Traffic Congestion and Retail Business.—The growth of these clearly defined districts within cities, each with its own shopping centers, suggests the degree to which retailing has already been decentralized. One of the outstanding reasons for this decentralization is found in present traffic congestion. Apropos of this situation, a prominent merchant of a large eastern city recently said: "If merchants do not do something to relieve the present traffic situation, within fifteen years there will be no downtown shopping districts of any importance." Such a statement, coming from a thinking American merchant, gives some idea of the seriousness of the traffic problem from the merchant's point of view.

Two problems are really involved. The first has to do with the customer reaching the store. Nearly every one wants to "go shopping" in his automobile, but in large cities only about 13% of customers do so, as compared with 50% in cities of under 10,000 population. The private automobile is notoriously wasteful of traffic space; some one has aptly said that if automobiles were to use street space as efficiently as do trolley cars they could only be as large as kiddie-cars. When people cannot reach the loop-district stores by automobiles, they are likely to trade in an outlying district.

The second problem concerns the movement of merchandise into and out of the store. Remote delivery stations, cooperative delivery systems, and various off-the-street loading and unloading plans are in use to lessen the seriousness of these problems. History tells that in Rome the earliest traffic regulations specified that merchants must not deliver during the day, because of the "narrowness of the streets and the need of their use for carriages." Similar methods might be adopted today to avoid some of the congestion, but to do so would delay deliveries from loop stores, thus giving a further incentive to decentralization.

The most important part of any city plan has been said to be the traffic plan. In many instances of city planning the retail merchants' viewpoint and problems have not been considered. Cities tend to become established with inadequate traffic facilities to handle trade. As a result, one of two things must happen. Either cities must be rebuilt at great expense to provide ample avenues of travel, or shopping will become more and more widely decentralized.

CHAPTER 17

INTERNATIONAL MARKETING

Trade a Result of Specialization and Division of Labor.—One of the characteristic features of present-day economic society is the extent to which each person is dependent upon every other person for the satisfaction of his wants of life. People have come to specialize more and more, and have come to depend upon an efficient marketing system to distribute the products of each in the proper manner. Elaborate transportation and communication systems have been built up to facilitate this interchange of goods, and to give to each person the benefit of other people's efforts.

The result of this interdependence is a closely knit economic organization within each country, each area depending upon every other area for the supply of a large part of its products. Certain strategic points—metropolitan centers—act as clearing houses in the exchange of goods. Here the surplus goods from the Metropolitan area are concentrated (converging movement) and from here goods are sent out to other areas needing those products (diverging movement). Thus, specialization is found also as between areas within any one country.

Division of labor and specialization is carried much further than just indicated, however. International boundaries are political, and do not coincide with economic or production areas. No country of present-day living standards is entirely self-sufficing; all depend to a greater or lesser extent upon the rest of the world to supply certain commodities. This was forcibly brought to the attention of society during the World War. A study of marketing must, therefore, include a brief mention of the international aspects of the problem.

Law of International Marketing.—There are two reasons why countries are not self-sufficing; the one is physical and the other economic. In the first place, no country has a climate or a geology suitable for the production of all commodities. Wheat cannot readily be produced in the tropics, nor can bananas be grown in the frigid zones. Thus a great deal of international commerce arises out of the interchange of commodities which may be produced only in certain areas. Such trade is mutually advantageous since it enables the consumers in each country to choose from a wider variety of goods, and to improve their standard of life.

Much trading between nations arises also out of the fact that the growing season differs between the northern and southern hemispheres. For example, improvements in transportation and refrigeration have brought a considerable supply of fresh fruits and vegetables to European markets from the southern hemisphere. Further, during the summer and fall months, locally grown produce and some fruits furnish a fresh supply in northern United States; during the winter and spring months a continuous supply of produce from the South, where the growing season is different, is available.

A second reason why countries are not self-sufficing is economic. As pointed out before, all marketing is based on comparative advantage and specialization, as between individuals, or between areas. Although a certain commodity may be produced by many nations, they cannot all do it equally well. One nation may have some advantages over the others, due to more favorable climatic conditions, to better natural resources, to more efficient labor, or for other physical or social reasons. Tea could be produced in the United States; but not nearly as advantageously as it is being done in the Orient. Bananas grow abundantly in Central America; they could be grown in Minnesota—under glass. Climatic conditions may be so favorable for wheat in one country that an average yield of 20 bushels per acre is obtained; another country differently located may be able to produce only an average of 10 bushels per acre.

These differences between areas and nations tend to result in specialization. Each area will produce what it is best suited for and exchange its surplus for some other goods. It is worth while as individuals to trade with the people of other communities when and only when their prices make it profitable to do so. Goods are produced and sold in order to obtain funds with which to buy other goods. Individuals, areas, and nations will generally produce those things which give them the largest money income. This is generally the same as saying that those goods will be produced which require the least effort and hence may be produced at the least cost in comparison with the cost elsewhere. This principle of trade is fundamental both in domestic and international marketing.[1]

By specializing in the production of the goods which may be most advantageously produced, and exchanging the surplus for other goods, a social gain results since more and a greater variety of goods may be enjoyed. The United States buys rubber from British Malay, coffee from Brazil, and tea from the Orient, because those goods cannot be advantageously produced at home. In exchange, cotton, wheat, automobiles, and other goods, which may be more advantageously produced here, are sent out. Thus each country may enjoy a greater variety of goods, and at a lower cost.

These facts give rise to both domestic and international commerce. Middlemen who perform the assembly functions are charged with the task of seeking out the most advantageous sources of supply, both at home and abroad. Thus the typical department store has goods obtained from all corners of the globe, either because they could not be obtained in the home country at all, or because they could be obtained more cheaply elsewhere.

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[1] The Law of Comparative Cost, on which trade basically depends, has been stated as follows: "Broadly speaking, in order to make the exchange of two commodities profitable it is only necessary that the comparative cost of the commodity exported by either of the two countries should be less in that country than in the importing country." F. M. Taylor, *Principles of Economics*, 1921, p. 224. This statement is sufficient for our present purposes, although in later studies it may be necessary to make a deeper economic analysis of the matter.

Middlemen Engaged in International Marketing.—Selling in foreign countries necessitates a somewhat different organization than that needed in domestic marketing. Some large manufacturers may have their own selling organizations; the smaller manufacturers, however, usually market through some middleman. A few of the typical middlemen aiding in the export trade are the following:[2]

1. Export Commission Houses. These organizations usually represent the foreign buyer. They are in that respect similar to the buying broker discussed in Chapter 6. Their main function is to seek out the best sources of supply for their foreign clients, and to purchase goods in accordance with instructions received. They usually attend to the details of shipping the goods, such as arranging for cargo space, preparing for freight, insurance, and so on. A commission of 2½% to 5% is paid by the foreign buyer. There are about one thousand commission houses in the United States, two-thirds of which are in New York City.

2. Export Merchants. Unlike the export commission house, the export merchants buy and sell goods on their own account, thus assuming all the risk of ownership. They usually have branches in various foreign countries, in order to keep in touch with demand conditions in the various markets. Export merchants usually specialize in one line of merchandise. There are relatively few export merchants in the United States.

3. Export Agents. These middlemen represent the sellers in the home country. They usually represent many firms, but seldom handle more than one line of merchandise. Many are, in effect, trade advisers to a few manufacturers, since they

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[2] See Norbert Savay, *Principles of Foreign Trade,* Ch. XII, and G. E. Snider, *Selling in Foreign Markets.*

have a good knowledge of the foreign market where they operate.

4. COOPERATIVE EXPORT ORGANIZATIONS. These are selling organizations set up by a few non-competing manufacturers. Joint catalogues may be printed, and joint advertising carried out; information regarding foreign markets can be obtained, both as to market needs and credit standings; joint shipments can often be made, thus reducing freight costs. This type of exporting agency is as yet not commonly found in this country; in Europe, however, it has been used extensively for some time.

Problems of International Commerce.—The performance of all the marketing functions is necessarily more complicated when goods must be bought from, or sold to, a foreign country. In the first place, *there are differences in market structure* between the various nations. Each country has its own peculiar historical development which has shaped its economic and commercial structure and institutions. Banking systems, and hence, methods of financing commodity distribution, differ widely between nations. The functions performed by the broker are different in England than in France, the American broker differs from both, and so on.

Second, *there are wide differences in race, religion, customs and habits* of various peoples, which affect their economic conduct, and, hence, marketing methods. The statement, "When in Rome, do as the Romans do," is true not only of social conduct, but of marketing methods as well.

The marketing methods in a given country are determined largely by its political, social, and economic status. Hence, a complete knowledge of conditions in a given country is essential to commercial success, and the need of studying the psychology and make-up of the foreign market mechanism is, therefore, manifest. An exporter needs to know the ways, manner, and temperament of the people with whom he deals.

For example, it is said that people in the United States are accustomed to "doing things in a hurry" while the people in South America appear to be more temperamental and slow in business dealings. A case has been cited which brings out this difference strikingly.

"An American company heard that there was a great opportunity in its line in South America. Forthwith the manager of the company picked out his best salesman, noted for quick work, and sent him down on the first steamer. The salesman had no experience in foreign trade. He looked at the map and decided upon the towns which were to supply his golden harvest, and upon the length of time that he would spend in each. He allowed two days to the smaller towns and a week to the larger ones. He arrived, hurried his sample trunks ashore at the first port, and spread out his wares at the best hotel. Next he called on the local dealers and invited them to look at his samples, announcing at the same time that his steamer was to leave in two days and that he had to go with it. To his great astonishment no one responded to his invitation. He waited another day but with no better results. He concluded that this time he had struck a dead town.

"It so happened that a few days later this American salesman was followed by a representative of a European house in the same line of trade. He came with letters of introduction, which he sent to the merchants soon after his arrival. Later he made personal calls on them, looked over their stores, and expressed his admiration for the way in which they were conducting their affairs. The merchants returned the call and the salesman established with all of them a basis of friendly intercourse. He continued his casual calls until in a day or so they began to show curiosity as to the sort of merchandise he was handling. To this he replied that if they wished to see his stock he would be glad to exhibit it to them at their convenience, but at present he was not in a hurry to sell them anything. Such methods strongly appealed to their Latin temperament and before he left many of the merchants gave him large orders."[3]

Third, *most countries have their own units of money, and of weights and measures.* The problem of converting the value of goods, expressed in terms of the monetary and quantitative units of one country, into corresponding terms of another country, makes the problems of international marketing much more complicated than those of domestic marketing. The rate of conversion of one monetary unit into another, that is the rate of exchange, is constantly fluctuating, thus causing an additional hazard for people engaged in foreign trade.

Fourth, *the transportation regulations and rulings in foreign countries are different from those at home.* The type of container which commands a low freight rate in one country may take a high rate in another, thus modifying the packaging of goods for export trade. Further, two articles which are classed together and given the same rate in one country may have widely different rates in another. In such a case the two articles must be separately shipped in the latter country or else the higher freight rate must be paid on both. Since transportation costs are of considerable significance in international competition, such traffic problems are of major importance.

Fifth, *the gathering of market news for foreign trade involves special problems.* It takes special effort on the part of a business man to obtain as complete and accurate information on the foreign market as is available for the home market. The problem is increased also by the size of the territory to be covered. This makes the cost of an adequate information service so high that dependence must be placed largely upon governmental or cooperative agencies.

There are, however, several sources which provide news of almost as great reliability as that available for domestic trade. These include the consuls and some other governmental representatives, who are really commercial agents of their home country. Moreover, each trade is often organized to furnish information to interested parties. Information is gathered also by various trade promoting organizations, by the export commission houses, by foreign offices of banks and large corporations, and by numerous export trade journals.

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[3] Norbert Savay, *op. cit.*, pp. 225–227.

Finally, *there are many impediments to international marketing,* such as tariffs, prohibitions, and other trade barriers, all of which serve to complicate the problem. In this connection it may be pointed out that there is no universal agreement as to the "best" national policy to follow. England has been largely on a "free trade" basis for many years, while the United States has followed a policy of tariff protection. Each country has prospered under its own régime—either because of, or in spite of, its tariff policy. A full consideration of the social and economic arguments involved in trade barriers must be reserved for advanced courses in International Commercial Policies and Foreign Trade.

Impediments to International Marketing.—Although the advantages of specialization between individuals and areas at home are universally recognized, most nations refuse to recognize the similar advantages in specialization on a world basis. Economic advantages resulting from trade cannot always overcome individualistic and nationalistic prejudices. Instead of seeing the virtues of exchange, nations see many disadvantages of being dependent upon the rest of the world for a part of their products. To eliminate such dependency, most nations are prone to create artificial barriers to prevent a natural flow of goods from areas of low cost production to areas of high cost production. International rivalry calls for national self-sufficiency. Hence, the theory is evolved that no goods should be imported which may possibly be produced at home—even though the cost of domestic production be much higher, and the quality be poorer.

The result is a protective tariff, ostensibly "to equalize cost of production at home and abroad," but practically for the purpose of keeping out foreign goods. All goods imported must hurdle the tariff barrier, "pay a fine" for being imported, usually raising their price in the importing market.

So far as marketing is concerned, the problems arise primarily out of the changeability of such trade barriers. Established channels of trade may be changed at any time by the imposition of a higher or lower tariff. A former good outlet for products may suddenly become closed, necessitating a rearrangement of the machinery built up by middlemen and exporters. Further, risk in international marketing is widely increased by the uncertainties of these changes.

Balance of Trade.—The notion has long been common that a tariff barrier was a desirable thing because, while goods could be kept out of the country, exporting would not be hindered in any way. Commodities in large quantities could be sent out, and money taken in return. Thus there would be a "favorable balance of trade," i.e., the value of goods exported would exceed the value of those imported. A country which imports much and *apparently* exports little, is said to have an "unfavorable balance of trade," and is hence to be pitied.

The fallacy of such arguments has already been pointed out.[4] National riches do not necessarily come with a "favorable balance of trade." The scale of living must be measured by the amount consumed, rather than by the amount produced. If more goods are shipped out of the country than are received in exchange, there is obviously less to consume. Money, or credit, may of course be received in exchange; but that can neither be eaten nor worn. Hence, temporarily at least, total consumption—and social welfare—is reduced by a favorable balance of trade. There are cases when a tariff or other trade barrier may be justified as a temporary expedient, if the protected or subsidized industry will enjoy natural advantages when once under way. This is the familiar "infant industry" argument.

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[4] See Chapter 4.

Actually, no nation can have a favorable balance of trade for any long period of time. If a nation is going to continue to sell goods, it must expect to buy goods in return. Neither can nations become entirely self-sufficing. Continued progress calls for more free interchange of goods between countries, not less.

Foreign Trade of the United States.—The annual value of the goods exported from the United States during the past twenty-five years has averaged about 11% of the total production of the country. The following table shows the percentage in different years for which official figures are available:

VALUE OF EXPORTS, AS PER CENT OF TOTAL PRODUCTION[5]

Year	Per Cent of Total
1899	12.7%
1909	9.6
1914	10.0
1919	16.4
1923	8.9
1925	10.1

The chart in Figure 19 illustrates the trend of exports and imports in the United States since 1890.[6]

Imports of goods have, during the same period, been nearly as large as exports. The goods sent out have thus been paid for mainly by accepting other goods in exchange. It is true, however, that the United States has had a "favorable balance of trade" for some time. The goods sent out in excess of those taken in return have been paid for primarily by services and other "invisible" items.

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[5] U. S. Dept. of Commerce, *Yearbook*, 1928, p. 93.
[6] *Ibid.*, p. 84.

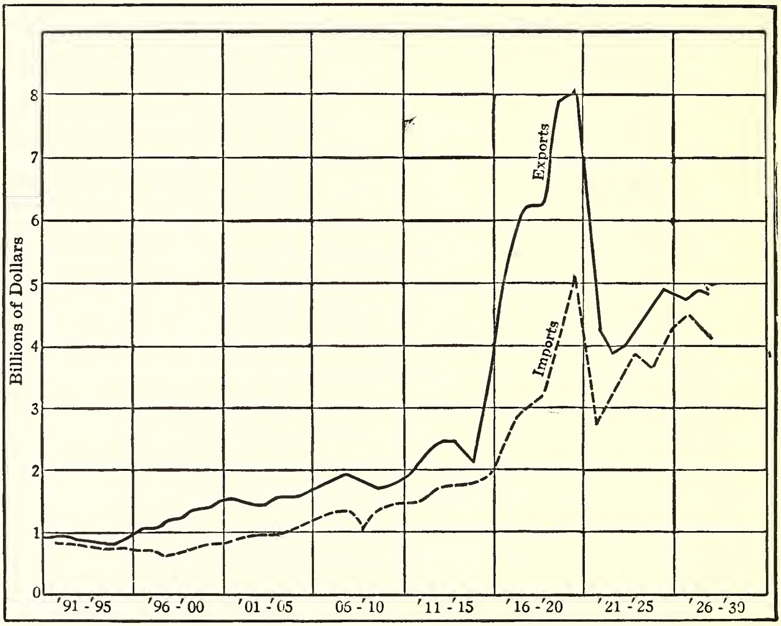

Figure 19. Merchandising Exports and Imports, 1891–1927

The United States was for many years primarily an agricultural and not a manufacturing country. In 1875, for instance, our exports of manufactured and semi-manufactured goods made up only 30% of our total exports. In 1925, on the other hand, they had grown to 65% of the total. During the same half-century, the percentage of crude materials imported to be manufactured into finished goods increased from 25% to 52% of our total imports. Hence, American manufacturing now forms the basis of our international trade. The following table shows the relative importance of the various classes of commodities entering into our foreign trade.

The following table is significant in that it shows our capacity to compete very favorably with foreign nations in manufacturing in spite of the supposed disadvantage of paying the highest wages of any country in the world.

PER CENT OF EXPORTS AND IMPORTS FOR DIFFERENT CLASSES OF GOODS, 1928[7]

Class of Goods	Exports	Imports
Crude materials	25.7%	35.9%
Crude foodstuffs	5.8	13.4
Manufactured foodstuffs	9.3	9.9
Semi-manufactured goods	14.3	18.6
Finished manufactured goods	44.9	22.2

The kinds of raw materials and other goods which we export are entirely different from those which we bring in. The following table shows the value of the leading exports and imports for 1928:

PRINCIPAL GOODS IMPORTED AND EXPORTED IN 1928[8]
(Millions of dollars)

Exports		Imports	
Cotton (raw)	$920	Silk (raw)	$370
Petroleum (largely refined)	525	Coffee	310
Machinery	500	Rubber (crude)	250
Automobiles	500	Sugar	210
Wheat and flour	190	Paper and manufactures	160
Packing house products	190	Hides and skins	150
Iron and steel-mill products	180	Petroleum (largely crude)	130
Copper and its products	170	Furs and manufactures	120
Tobacco (unmanufactured)	150	Paper base stocks	115
Cotton manufactures	135	Tin	90

Thus it is seen that the products imported are largely crude materials, whereas a large proportion of the goods exported are manufactured articles, such as machinery and automobiles. The above table includes, of course, only the principal items.

GEOGRAPHIC DISTRIBUTION OF FOREIGN TRADE. A country may buy large quantities of goods from another and yet not send that country the equivalent value in other goods. The following table shows the principal countries traded with in 1928.

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[7] U. S. Dept. of Commerce, *Yearbook*, 1929, p. 109.
[8] *Ibid.*, pp. 114, 117.

VALUE OF EXPORTS AND IMPORTS WITH LEADING COUNTRIES IN 1928[9]
(Millions of Dollars)

Exported to:		Imported from:	
Canada	$920	Canada	$490
United Kingdom	850	Japan	390
Germany	470	United Kingdom	350
Japan	290	Brazil	220
France	240	Germany	220
Argentina	180	British Malay	205
Italy	160	Cuba	200
The Netherlands	145	France	160
Australia	140	China	160
Cuba	130	Mexico	125

Europe has always taken a much larger share of our exports than any other continent, but in 1927, for the second consecutive year, it took less than one-half of the total. The proportion of our exports going to Europe has diminished from 75% at the beginning of the present century to 47½% in 1927. This rather steady decrease has taken place in spite of a substantial growth in the value of our exports to Europe. This emphasizes the expansion of our trade with non-European countries, of which Canada, Latin America, and the Orient are of increasing importance.

Settlement of International Balances.—Six of the ten countries to which we sent the largest quantities of goods also sent us a great deal, but not an equivalent amount. The difference in value between goods received and goods sent out may be settled in any one of the following ways:

1. *By money payment.* As pointed out before, this method could not for long be used to settle balances, since only gold is acceptable, and gold is very limited in amount.

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[9] U. S. Dept. of Commerce, *Yearbook*, 1929, p. 132.

2. *By triangular trade.* This is the most common method of settling balances between nations. Country A owes country B; country B owes country C; country C owes country A. By an offsetting process, no actual cash need be paid out by any country, except small amounts.

3. *By borrowing.* This does not mean that goods are bought on time, but rather that governments or individuals in the importing countries get funds by selling securities to governments or individuals in the exporting countries, with which to pay for their purchases. This is, of course, only a temporary method of settlement.

The whole mechanism of international settlement of balances is complicated, and beyond the scope of this treatise.

CHAPTER 18

COSTS OF MARKETING

Primary Production and Marketing as Complements.—Marketing is one phase of production. If goods are to be consumed in satisfaction of human wants they must be available in the right place, at the right time, just as truly as in the right form. It follows, then, that before goods are fully "produced," decision must be made as to where, when, and in what quantity they are desired. To that end they must be stored and transported. These operations are facilitated by adequate financing and by grading in accordance with established standards. Prospective purchasers must be informed of available supplies. No matter how thoroughly the marketing operations are planned, there remains an element of risk which must be borne by some one connected with the process. In other words, the cost of marketing is the sum of the expenses incurred in performing each of the marketing functions. Cost figures furnish one objective test of the relative efficiency with which these functions are performed.

It was pointed out in an earlier chapter that the expenses of marketing are absorbing an increasing percentage of the consumer's dollar. This is clearly indicated by the fact that at present 25% of the people gainfully employed in the United States are directly concerned with selling and distributing products, as contrasted to only 10% fifty years ago. From this it cannot be inferred, however, that marketing is less efficiently performed than formerly, nor that there is social waste in its rising costs. Such may be the case, but it must be remembered that marketing is one phase of production. If newer marketing methods have made possible economies in primary production, consumers may be receiving more goods in exchange for their efforts, rather than less. In other words, primary production and marketing complement each other. If the rising costs of marketing are more than offset by lowered costs in industry, a net social gain results.

Such a net social gain clearly has occurred when output and input are measured in physical terms. Input, i.e., the per capita hours of labor of all sorts, has been lessened; output, i.e., the per capita volume of goods available for consumption, has been increased. Marketing methods have played a part in this social change, through providing a wide market for individual offerings, thus making possible in primary production the economies of specialization and large-scale operation. In this sense the different phases of production must be evaluated jointly.

In another sense, however, it is proper to study the expenses of marketing *per se,* to learn the efficiency with which the functions are being performed. After a combined program of primary production and marketing has been undertaken, each step in the total process may be tested and governed by the research methods suggested in Chapter 13. For example, after a shoe manufacturer has decided to distribute shoes through his own retail outlets, he should study intensively the location of each of those outlets, the layout within the individual stores, the model stock and slow-selling lines for each separate clientele. The expenses of each operation should be checked against figures from other stores and for other years within the store. Only in this way can the weak points be discovered and corrected.

Such studies of marketing have been made in increasing numbers during recent years, until cost data are available as guides both as to the most efficient market structure for particular commodities and as to operation of the individual store. As a result, both social waste and the difficulties of individual management are being reduced.

Some Reasons for the High Cost of Marketing.—One outstanding reason for the relatively high cost of marketing has been suggested, namely, *the effort to reach a wider market* so that economies in primary production might be realized. There are other equally cogent reasons, however. These were outlined in Chapter 2. They are restated here for emphasis, as follows:

1. There has been less application of power and machinery to marketing than to primary production. Considerable physical force is often required to bring about changes in the form of commodities. Moreover, such changes often may be performed in large quantity and at a regular rate. At least the final stage of marketing (retailing), on the other hand, depends upon the whims and vagaries of consumers. It is carried on in small-scale units, and the opportunity for use of either power or machinery is limited.

2. Since more goods are produced than formerly, more goods must be sold. This has tended to increase the relative cost of marketing because, while production has generally been on a decreasing cost basis, human desires have been slow to expand, so that it has taken an increasing proportion of sales promotion to move the new goods.

Increases in varieties of goods and in rapidity of style changes have intensified the problem of persuading people to consume the products of industry. In the first place, people must be told of new ways to satisfy their basic desires, and then, in many cases, they must be convinced that the new method will really bring satisfaction. Keen competition between the products of different manufacturers sometimes increases costs without increasing satisfactions, because of the necessity which it entails both for increased sales promotion and for the carrying of a greater variety of goods by the merchants.

3. An increasing economic separation has developed between the places where specific goods are produced and where

they are consumed. This is partly a matter of increasing physical distance which has been coincident with the geographic specialization of industry and the concentration of population at industrial centers. To a growing extent, foodstuffs must be shipped into cities, and as the congestion increases, the cost per unit for physical distribution increases. Moreover, the goods which result from the specialized manufacture in cities must be distributed to other consuming areas. It is partly a matter, also, of the growing congestion of traffic within the city terminals. Much time and effort are consumed in intra-city distribution even after the products of specialized areas have been concentrated in the terminals.

4. Consumers are receiving and requiring certain "services" which previously had not occurred to them. Purchases are made in very small units, credit is extended, and goods are delivered. In the shopping institutions, such as department stores, there are many other types of special services available, such as rest rooms, eating rooms, lecture rooms, and what not.

All of these things have undoubtedly contributed to the increasing cost of marketing, relative to manufacturing and other forms of production.

Costs in the Central Markets.—Industrial goods are generally less costly to market than are consumer goods. This is especially true of primary materials which are concentrated in central markets. The marketing organizations which have developed in connection with the handling of grain, cotton, livestock, steel, and other similar products are, in general, relatively efficient. Among the conditions which make low costs possible with most primary materials are large-scale marketing operations, standardized products, and rational motives on the part of buyers.

Costs of Marketing Wheat.—

COUNTRY ELEVATOR COSTS.—The case of wheat is illustrative of primary materials. The first link in the chain for wheat marketing is the country elevator. Costs of operating country elevators in Minnesota have been studied by the College of Agriculture of the University of Minnesota. The following figures show the average operating costs for each of several recent years:

1912–13	2.54 cents per bushel
1917–18	3.71 " " "
1920–21	4.13 " " "
1924–25	4.70 " " "

From these data it appears that money costs have risen consistently during the past 15 years. In comparing these figures for specific years it must be remembered, however, that, on the average, a dollar would buy only two-thirds as many goods and services in 1925 as in 1913; that is, there had been a general fall in the value of the dollar. Even when allowance is made for this fact, the cost of operating country elevators apparently increased about 22% during the period.[1]

For one recent year an analysis was made of the costs for elevators handling different volumes of grain. The following figures resulted:

Bushels Handled	Expenses per Bushel
30,000	4.70 cents
50,000	3.85
100,000	2.72
150,000	2.20
200,000	1.99
250,000	1.85
300,000	1.73
Typical....... 122,000	2.54

These data strongly suggest that economies of operation might be expected if small country elevator companies were to combine so as to eliminate the high costs of operating elevators with a small volume of business.

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[1] Another way of stating this relationship is to say that the money costs in 1924–25 would have been approximately 3.10 cents per bushel in terms of 1912–13 dollars.

It was further found that the range in costs of operating individual elevators was from 1.7 cents to 13.0 cents per bushel. Seventy per cent of the elevators studied had costs between 3 cents and 6 cents per bushel, while 12% had costs of 8 cents or over. If these high-cost elevators could be eliminated through better organization and management, a real social saving would result.

Commission Charges. Wheat is next sent to the terminal or central markets, where it generally is sold by a commission firm. The commission charges on wheat in Minneapolis, for example, are 1% of the price, but they are always within the range of 1.5 cents per bushel minimum to a 2.5 cents maximum. That is, if the price is $1.50 per bushel or lower, commission is charged at the flat rate of 1.5 cents; if the price is between $1.50 and $2.50, the commission is 1% of the price; but it never goes over 2.5 cents regardless of how high price may go. These charges cover the expenses of operating a commission business and there seems to be little opportunity to lower them.

Terminal Market Charges. The commission firm most frequently sells for storage in a terminal elevator, where additional costs are incurred. There is a total charge of 1.5 cents per bushel for handling into and out of the elevator. The payment of this charge carries with it fifteen days free storage, after which 1/30 cent per day storage accrues. If two lots of grain are to be mixed into one even-running grade there is a charge of .5 cents per bushel for each elevation, and if the grain is cleaned there is an additional charge of .5 cents per bushel.

These several charges are the total cost of passing grain through the terminal elevator. The remaining step is the purchase of the wheat by the miller. When this transaction is carried out in the cash market of the grain exchange it involves another commission charge, as well as the services of the mill's expert buyer.

Transportation. The cost of transportation is an additional part of the marketing expense. It includes the movement of the grain from the country elevator to the terminal and, often, subsequent movement to the mill. These charges will vary in accordance with the point of origin of the grain and the particular terminal elevator in which it is stored.

Summation of Costs. The total cost of marketing grain includes, therefore, the following items:

Middlemen	Cents per Bushel[2]	
Country elevator	3.0 to	6.0
Commission	1.5	2.5
Terminal elevator:		
In-and-out charge	1.5	1.5
Storage (2 to 4 months)	2.0	4.0
Commission	1.5	2.5
Transportation	10.0	30.0

Transportation is by far the largest single item of expense, generally equal to all of the others combined. The other expenses are all relatively low, showing a high degree of perfection in the market machinery which has been developed for the handling of grain.

From Wheat to Bread. After wheat is sold to millers it is manufactured into flour. Most of the flour is subsequently sold to bakers for the commercial manufacture of bread. It is possible, through published records, to trace the approximate costs throughout the entire chain from wheat on the farm to bread on the consumer's table. The following figures show the average division of the consumer's dollar spent for bread in recent years.[3]

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[2] These are not the outside limits of cost, but are those between which the majority of transactions fall. It is not proper to add the two columns for comparison of high and low total costs, because neither all of the highs nor all of the lows would ever occur together in a specific case.

[3] Based on figures in the report of the Joint Commission of Agricultural Inquiry of the 67th Congress, October, 1921.

Items	Primary Production	Marketing
Retailer retains		20.0 cents
Baker's selling expense (including delivery to retailer)		16.0
Manufacture of bread (including cost of materials other than flour)	25.0 cents	
Transportation of flour		3.3
Manufacture of flour	1.0	
Marketing of wheat (including storage charges)		2.0
Transportation of wheat		2.7
Grain grower receives	30.0	
	56.0 cents	44.0 cents

From these figures it appears that changes in the costs of marketing *wheat* could have no practical effect on the consumer's price of bread, because they are already so small a part of the cost of the finished product.

Costs of Marketing Milk.—As another illustration of agricultural commodity marketing we may consider the case of milk. Milk is used in part as a primary material in the manufacture of butter, cheese, and other products; the costs here considered, however, are those of marketing it for direct consumption. The organization and methods used in the Twin Cities market are representative of those in large cities generally, so that data from this market are presented as typical of common practice.

The Twin Cities Milk Producers' Association is a cooperative organization of dairymen who individually produce milk for market and who collectively sell that milk to the distributors in the cities. The total expense of marketing through this cooperative organization in a recent typical year was 16.7 cents per hundred pounds of milk, or approximately 5.25% of the central market price. This cost included all the services of the cooperative organization and the transportation expense of sending the milk by truck from the scattered farms to the central market. Here, again, the low cost of concentrating a commodity in the central market is demonstrated.

The final step in marketing milk is carried out by the distributors who get their milk from the producer organization. In a recent year the distributors' buying price was 6.02 cents per quart and their selling price was 10.0 cents. The difference between the two, or 3.98 cents, was the cost of processing and retail distribution. Of this amount, .98 cents was taken for processing, i.e., pasturizing, grading, and so on. This left a retailing cost of 3 cents per quart, or 27% of the retail price. The great difference which exists between the expenses of wholesaling (in this case performed by the producers' organization) and those of retailing is here clearly illustrated; wholesaling expenses, including transportation to the central market, were only 5.25% of selling price, while retailing expenses were 27%. In spite of the perishable nature of the commodity, and the care and rapidity in handling which that necessitates, the total expense of selling to the retail distributor is lower than that for almost any other consumer good. The retailing expenses, on the other hand, are comparatively high as a result of the nature of the commodity and the delivery services expected by the consumers.

Central Market Costs for Fruits and Vegetables.—Fruits and vegetables are produced in many cases at considerable distance from the consuming centers in large cities. For this reason, transportation charges are a large part of the marketing costs with these commodities. The accompanying graph (Figure 20) shows the division of the wholesale price for specific articles, as reported from a governmental investigation. The wholesale price is divided, in each case, into the portions which go, respectively, to (1) the original shipper, (2) the transportation company, (3) miscellaneous handling agencies, (4) the carlot receiver. In some instances the wholesale price did not cover all the costs, in which cases the receiver suffered an out-of-pocket loss on the transactions. The receiver's share varied from a loss of 10% on California cabbage and onions, to a gross margin of 20% in the case of tomatoes. Transportation charges were approximately 75% of the wholesale price of cabbage, but only 12% of the price of strawberries. The shipper received over 80% of the price of northern grapes, but only 12% of the price of Texas cabbage. On the average, one-third of the wholesale price was absorbed by transportation charges, while all the other central market charges were only 8% of price.

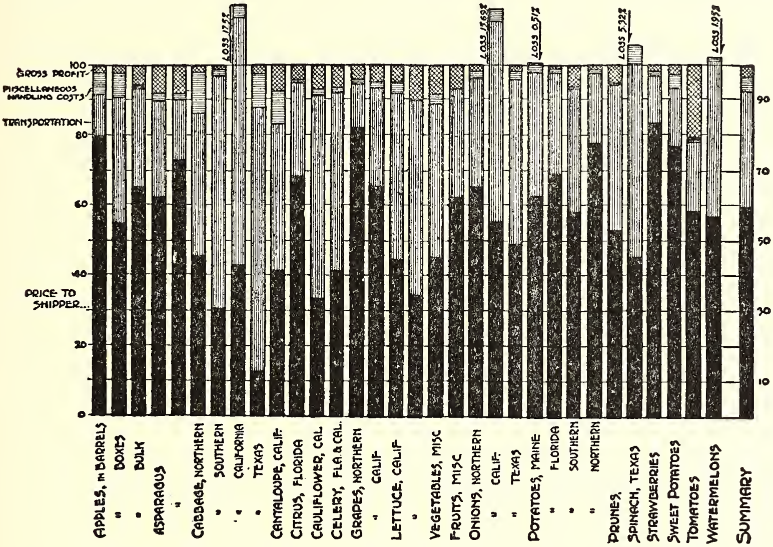

Figure 20. Fresh Fruits and Vegetables—Showing the Distribution of the Proceeds from 9,476 Representative Cars Sold at Wholesale in Boston, Chicago, New York, Philadelphia, Pittsburgh, and Other Cities During Period September, 1920, to July, 1921 (Joint Commission of Agricultural Inquiry)

Costs of Marketing Industrial Goods.—Satisfactory data on the costs of marketing many industrial goods are lacking. There are some points, however, on which information is available. The costs of marketing wheat, for instance, have been given and are somewhat typical of costs with other raw materials. With some raw materials—ores for example—the transportation expense is high relative to the value of the commodity. Consequently, smelting and some other preliminary processing are often undertaken near the mines. With coal, also, transportation expense is an important item, being over half the delivered price in many cases.

Installation goods are frequently designed for a specific situation. In such cases, it is difficult to allocate costs between primary production and marketing. The man who originally obtained the order was probably a combination of salesman and engineer, so that the cost of his services might be considered in either category.

Machines and equipment which are made for stock installations and sold without much technical advice may be sold to the user by the manufacturer's salesmen, or they may be distributed through sales agents, wholesalers, and retailers, or other trade channels. Regardless of the method of distribution, it may be said that the price paid by the user is generally from 50% to 100% above the factory costs of primary production. This is equivalent to saying that marketing costs are from 33⅓% to 50% of the consumer's price.

Advertising is probably not the most important part of selling industrial goods and yet the amount expended for this purpose is considerable. The 137 members of *Associated Business Papers, Inc.*, report that the total advertising space used in their papers during 1928 was valued at $36,668,978 as compared with $29,436,918 for 1927. All of this was industrial advertising, representing an attempt on the part of manufacturers to sell their products to other manufacturers. There is also a growing tendency for industrial advertising to appear in popular publications such as the *Saturday Evening Post* and the *Literary Digest*, the cost of which is not included in the above figures. Moreover, the use of house organs in direct-mail advertising is an important industrial marketing expense. A recent survey indicates that about 2,000 such publications appear regularly, with a combined circulation of 180,000,000 copies. The annual expense is approximately $21,000,000. As with all advertising, these expenditures are made because they are expected to result in the most economical or the most profitable distribution of goods.

The Manufacturers' Selling Costs.—Many of the goods concentrated in central markets are sold to processors or manufacturers, who prepare commodities for human consumption. These manufacturers then start the finished goods through one of the several channels of distribution on their way to the final consumer. The government report already referred to gives the manufacturers' average marketing cost for 8 groups of trade-marked food commodities. The average reported for a seven-year period is divided as follows:

Selling and handling	9%	of	manufacturer's	price
Advertising	5%	"	"	"
Transportation	6%	"	"	"
		"	"	"
Total	20%	"	"	"

Trade-marked clothing and shoes are frequently sold by manufacturers directly to retailers. The manufacturers' selling costs, therefore, combine those of the manufacturers with those of the wholesalers. These costs for clothing and shoe manufacturers are between 15% and 20% of the manufacturers' price.

These examples are apparently typical of manufacturers' costs of selling consumer goods to the trade.

Costs of Wholesaling and Retailing.—The final stages of distribution of consumers' goods are wholesaling and retailing, which together are sometimes referred to as merchandising. In 1925, the National Distribution Congress brought together many of the available data on the costs of these two marketing operations. These data have been supplemented by more recent studies of bureaus of business research, trade associations, and so on. Many tabulations of the results of such studies might be undertaken. For example, Figure 21 shows the approximate division of the consumers' dollar between the primary producers, wholesalers, and retailers, for each of several lines of commodities. Retail costs are shown to vary from 19% to 40%, for different kinds of goods. Wholesalers retain from 5% to 19%, and the manufacturer receives from 48% to 76% of the money originally paid to the retailer.

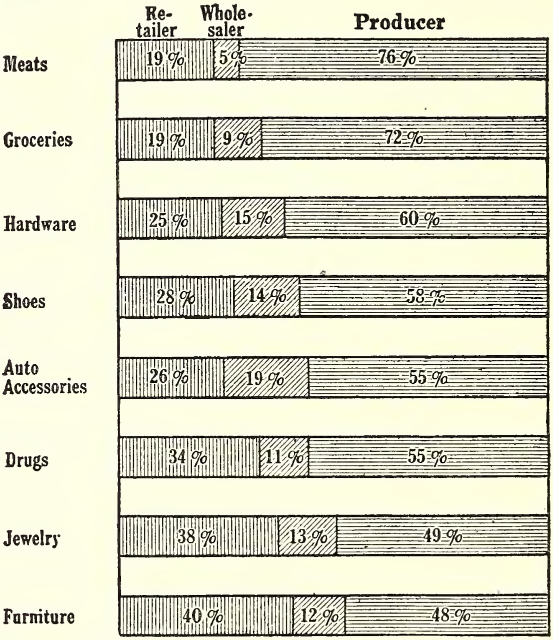

Figure 21. Division of Consumer's Dollar Among Retailer, Wholesaler, and Producer

In every case retailing is materially more expensive than is wholesaling. This is due to three principal factors, namely, (1) the wholesaler deals in larger lots, which makes his handling costs lower per unit; (2) the retailer expends greater proportional energy on demand manipulation; (3) the ultimate consumer receives many services from the retailer, such as attractive salesrooms, which are not always required of the wholesaler.

WHOLESALE EXPENSES OF DOING BUSINESS IN 1923
(Expressed as Percentage of Net Sales)

	Groceries %	Drugs %	Dry Goods %	Hardware %	Auto Equipment %
DIRECT SELLING EXPENSE:					
Sales force expense	2.60	3.60	5.70	4.76	7.80
Advertising	0.06	0.15	0.13	0.65	0.80
Other selling	0.09	0.09	0.15		0.25
Total Selling Expense	2.75	3.84	5.98	5.41	8.85
WAREHOUSE EXPENSE:					
Wages of receiving and shipping force	1.20	2.70	0.80	2.24	1.80
Packing cases and wrapping	0.05	0.27	0.13	0.19	0.20
Outward freight, etc	0.90	0.55	0.16	0.54	0.50
Total Warehouse Expense	2.15	3.52	1.09	2.97	2.50
ADMINISTRATIVE AND GENERAL EXPENSE:					
Executive and office salaries	2.00	3.40	2.80	3.90	4.80
Office supplies	0.20	0.36	0.20	0.45	0.70
Telephone and telegraph	0.07	0.11	0.05	0.09	0.25
Rent, light, heat, power	0.58	0.84	0.80	1.37	1.40
Insurance	0.15	0.20	0.25		0.30
Other general expense	0.35	0.55	0.95	0.49	1.20
Losses from bad debts	0.40	0.30	1.00	0.40	0.70
Total General Expense	3.75	5.76	6.11	6.70	9.35
OTHER CHARGES:					
Repairs and depreciation	0.11	0.18	0.14	0.40	0.27
Taxes	0.30	0.40	0.50	0.71	0.40
Interest	1.50	1.90	2.80	3.33	2.00
Total Other Charges	1.91	2.48	3.44	4.44	2.67
TOTAL EXPENSE	10.60	15.60	16.60	19.59	23.40
Margin	11.30	17.00	17.60		24.90
Profit	0.70	1.40	1.00		1.50
Cost of merchandise sold	88.70	83.00	82.40		75.10
Stock turn—times per year	5.9	3.9	3.4		3.4

It also appears that convenience goods, such as meats, groceries, and hardware, are the least expensive to merchandise. Specialty goods, such as shoes and auto accessories, are more expensive; jewelry and furniture, for which people shop, have the highest marketing costs. The differences exist especially in the costs of advertising, interest, rent, and the wages of the sales force. The privilege of shopping is expensive. The high relative cost of retailing drugs—generally considered a convenience line—is explained, in part, by the expenses connected with the prescription department; some manufacturing costs are included at that point in the retailing figures.

The table on page 301 gives the most common operating expenses in certain wholesale trades for 1923, expressed as percentages of net sales. The table below gives similar figures for retailing. In these tables, expenses are classified according to major items of expenditure. Such figures show the relative costliness of the various items in the merchandising expense budget. They provide a rough standard against which the efficiency of an individual firm may be checked.[4]

Retail Expenses of Doing Business in 1923

(Per Cent of Net Sales)

	Groceries %	Auto Equipment %	Shoes %	Department Stores %	Jewelry %
Total salaries and wages	10.6	12.4	14.7	15.4	17.1
Advertising	0.3	1.5	2.2	2.9	2.8
Boxes and wrapping	0.6	**	0.2	1.2	1.1
Delivery	1.2	1.0	0.25	**	0.35
Office supplies and postage	0.15	0.5	0.4	**	0.6
Telephone and telegraph	**	0.3	**	0.25	**
Rent	1.3	3.0	3.5	2.8	4.5
Light, heat, power	0.3	0.7	0.6	**	0.85
Taxes and licenses	0.2	0.3	0.5	0.5	1.0
Insurance	0.15	0.6	0.5	0.35	0.6
Depreciation and repairs	0.4	0.9	0.6	0.85	1.0
Total interest	1.0	1.8	2.7	1.8	4.6
Miscellaneous	0.7	1.7	1.0	2.15	1.5
Losses from bad debts	0.35	0.8	0.2	0.2	0.4
Total expense	17.3	25.5	27.4	28.4	36.4
Gross margin	19.1	25.7	29.1	32.0	38.3
Profit (net)	1.8	0.2	1.7	3.6	1.9
Cost of goods sold	80.9	74.3	70.9	68.0	61.7
Stock turn—times per year	10.1	4.5	1.9	3.7	0.9

**Included in miscellaneous.

NOTE: 1923 data are used in this and the preceding table because comparable series are available for a larger number of trades for that year than subsequently.

Individual Stores Vary From the Figures Cited.—The figures which have been reported indicate the most common expenses for stores of the class described. Individual stores vary widely from these figures, however. For example, for the 180 large department stores reported by the Harvard Bureau of Business Research for 1927, the most common expense was

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[4] Sources of data: Harvard Bureau of Bus. Res., Bul. 52 and 74, and report of National Distribution Conference, 1925.

31.4% of sales. The middle 50% of the stores had expenses which varied from 29.15% to 33.5% of sales. One-fourth of the stores had expenses lower than 29.15%, and one-fourth ran above 33.5% of sales.

Professor Secrist of Northwestern University has shown that, for the clothing and hardware trades, there is a marked tendency for individual stores to approach the average expense percentage for the group. Stores with low cost one year tend to increase their relative expenses subsequently, while high-cost stores tend to decrease theirs.[5]

Consumers pay enough for the services of retailing and wholesaling to keep the high-cost operators in business. If it were possible to eliminate these latter in favor of the moderate-cost and low-cost firms, consumer prices should be reduced automatically. This end can be attained, however, only when a sufficient number of adequately trained executives undertake to manage merchandising institutions in accordance with the scientific methods outlined in Chapter 13.

Analysis of Cost Data.—Further analysis of the available data on costs of merchandising discloses many interesting and significant side lights. The following points are especially suggestive:[6]

1. *Merchandising costs are continuing to increase relative to total net sales,* even within very recent years. Although comparable data are available for only a few years and a few trades, those which are at hand are so consistent in their direction that they are convincing, as indicated by the following table. In each case the earliest and the latest years for which data are available are reported.

It is, in part at least, this continuing increase in the costs of retailing which has afforded the impetus for the rapid

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[5] H. Secrist, *Expenses in the Retail Clothing Industry; Margins, Expenses and Profits in the Retail Hardware Industry.*

[6] Unless otherwise stated, the following analyses are based upon the data given in the two tables on pages 301 and 302.

Recent Changes in Operating Expenses in Various Merchandising Lines, Expressed as Percentage of Net Sales

	Year	Expense
Retail:		
Groceries	1919	14.6%
	1924	18.0
Shoes	1919	24.0
	1923	27.4
Hardware	1919	21.0
	1927	25.5
Department stores	1921	27.8
	1928	31.7
Specialty stores	1923	29.6
	1928	32.3
Jewelry	1919	32.3
	1927	39.6
Wholesale:		
Groceries	1919	9.1
	1923	10.6

development of chain merchandising and similar innovations discussed in the next chapter.

2. *Costs of retailing are different for stores of different size.* For grocery, shoe, and clothing stores, the costs are lowest in medium-sized stores, as indicated in the following tables:

(a) Operating Expenses in Independent Retail Grocery Stores in 1924

(Classified According to Volume of Sales Expressed as Percentage of Net Sales)

Sales	Expense
Under $30,000	19.9%
$ 30,000 — $ 49,000	17.9
50,000 — 99,000	17.5
100,000 — 149,000	18.0
150,000 — 249,000	18.2

(b) Operating Expenses in Retail Shoe Stores in 1923

Sales	Expense
Under $30,000	27.8%
$ 30,000 — $ 49,000	25.5
50,000 — 99,000	26.7
100,000 — 249,000	27.5
250,000 and over	32.0

(c) Operating Expenses in Retail Clothing Stores in 1919

Sales	Expense
Under $40,000	19.62%
$40,000 — $ 80,000	18.05
80,000 — 180,000	19.99
Over $180,000	21.47

Data on operating costs in jewelry stores and drug stores afford further illustrations of this same general tendency of costs to increase whenever sales exceed a medium amount. Apparently it is expensive to attract and serve a large clientele. In the case of grocery and clothing stores the principal increases in expense are found in salaries of sales force and in advertising. In the case of shoe stores, rent also increases as a percentage of sales, as the volume of sales grows larger; apparently a more elaborate salesroom is a necessary and costly item in the aggressive selling of shoes.

On the other hand, among meat markets, hardware stores, and tire and auto accessory stores, the expenses of operation as a percentage of sales appear to decline as the volume of sales increases. The operating expenses for hardware stores in towns of 3,500 to 10,000 population are given in the following table, to illustrate this point.

Department store expenses have been analyzed with this point in mind only to an upper limit of $10,000,000 sales.

OPERATING EXPENSES IN HARDWARE STORES—1928[7]
(Expressed as Percentage of Net Sales)

Sales	Expense
Under $25,000	33.88%
$ 25,000 — $ 40,000	27.36
40,000 — 60,000	25.15
60,000 — 100,000	22.46
100,000 and over	21.81

Their behavior is indicated by the following figures for a recent year, which appear to show the typical effect of volume of sales on expenses in department stores.

OPERATING EXPENSES IN DEPARTMENT STORES—1924
(Expressed as Percentage of Net Sales)

Sales	Expense
Under $250,000	27.5%
$ 250,000 — $ 499,000	28.2
500,000 — 999,000	29.4
1,000,000 — 3,999,000	30.5
4,000,000 — 9,999,000	29.7
Over $10,000,000	29.0

It seems probable that when increases in sales by individual department stores result from an increase in the population within the territory already served by the store or a decrease in local competition, costs will be reduced relative to sales. On the other hand, when growth results from an expansion of the trading and delivery area or from intensive publicity, costs are likely to be increased.

3. *Operating expenses in wholesaling are not affected by the volume of sales* to the same extent as are the expenses of retailing. The following figures are typical of recent experiences.

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[7] *Survey of Retail Hardware Stores,* 1928, Part 4, dealing with towns of 3,500 to 10,000 population.

Operating Expenses of Wholesale Establishments
(Expressed as Percentage of Net Sales)

Volume of Sales	Auto Equipment	Drugs	Groceries	Hardware
Small	25.20%	16.00%	10.60%	20.03%
Medium	22.70	15.40	10.30	19.19
Large	23.50	15.50	10.80	18.91

In three out of four of the trades for which data are available, the stores with the medium volume of sales have the lowest relative operating expenses, while in the fourth case expenses are lowest in the largest establishments. The direction of movement is entirely consistent, although the reductions in relative expenses are not very large in any case.

These figures, for both retail and wholesale firms, suggest the possibility of increasing the efficiency of distribution by limiting the number of outlets in some way so that all will reach approximately the optimum size. As a matter of fact, since data of the sort just discussed have become available, there has been a marked approach toward the optimum sales volume in the modal stores.

4. *Operating expenses are generally higher in large towns or cities than in smaller ones,* for any particular type and size of store. For example, the statistics published by the National Retail Hardware Association show that the average expense in proportion to sales varied as follows in 1928 in towns of different size:

Size of Town	Expense
Less than 1,000	20.40%
1,000 to 3,500	22.27
3,500 10,000	24.61
10,000 50,000	27.16
Over 50,000	29.10

While data are not available for trades other than hardware, common observation suggests that the same tendency prevails generally.

It is also generally believed that expenses are higher relative to sales in central shopping districts than they are in neighborhood centers, although conclusive evidence is not available on this point. This suggests that some social gain might result from a less centralized location of retailing.

5. *One of the most consistent accompaniments of low relative operating expenses is a high rate of stock turn.* Stock turn may be defined as the ratio between net sales in dollars and the average inventory, or stock of goods on hand, at selling prices. For instance, if sales have totaled $10,000 during a certain period, while stock on hand at the beginning of the period was $2,100, and at the close of the period $1,900, the rate of stock turn is $10,000 divided by the average between $2,100 and $1,900, or 5. The rate of stock turn may be increased, obviously, either by decreasing the stock carried on hand without modifying sales, or by increasing sales without modifying the average stock. To do either of these things requires more careful, and generally more frequent, buying.

As the ratio of sales to stock increases, the interest charge on money invested in stock becomes smaller relative to sales, thus lowering expenses. Moreover, there is undoubtedly some direct saving in handling and storage expenses.

Rapid turnover is, however, more of an indication of general efficiency than it is a direct cause of low cost. Particularly the assembly function must be more accurately performed in order to have goods in stock which consumers will buy readily, and which need not be closed out at bargain prices. The coincident movement of stock turn and expenses is indicated by the tables on page 309.

In both wholesaling and retailing, from one-third to one-half of the reduction in expense is accounted for by the reduction of interest and other direct charges. The rest of the

WHOLESALE EXPENSES OF DOING BUSINESS, CLASSIFIED ON BASIS OF STOCK TURN
(Expressed as Percentage of Net Sales)

Stock Turn	Auto Equipment	Drugs	Dry Goods	Groceries
Slow	25.50%	16.30%	18.20%	11.70%
Medium*	22.80	15.70	16.30	10.70
Fast	22.00	15.00	15.10	9.90

*The stock turn limits for the medium class are as follows: auto equipment, 3.0-3.9; drugs, 3.4-4.3; dry goods, 3.0-3.9; groceries, 4.5-6.9.

RETAIL EXPENSES OF DOING BUSINESS, CLASSIFIED ON BASIS OF STOCK TURN
(Expressed as Percentage of Net Sales)

Stock Turn	Department Stores	Groceries	Jewelry	Shoes
Slow	33.0%	19.7%	42.5%	30.6%
Medium*	31.8	17.6	39.1	27.4
Fast	30.2	17.4	35.9	25.7

*The stock turn limits for the medium class are as follows: department stores, 3.0-3.9; groceries, 7.0-11.9; jewelry, 0.8-1.1; shoes, 1.4-2.7.

reduction comes from indirect savings which are not clearly indicated by accounting data.

6. *Who gets the saving that comes with increased efficiency—the merchant or the customer?* From such data as are available, it appears that the gain from the reduction in expenses relative to sales, which have accompanied high stock turn and efficient operation, is largely retained by the efficient stores as an increase in net profits. Until competition becomes so keen that the inefficient or high-cost merchants are forced out of business, the efficient merchants need not reduce their prices to consumers. The following figures indicate that in spite of the lowering costs accompanying rapid stock turn, the retailer's gross margin has not been materially reduced, while his profits have been strikingly raised.

Gross Margins in Retail Stores, Classified on Basis of Stock Turn
(Expressed as Percentage of Net Sales)

Stock Turn	Department Stores	Groceries	Jewelry	Shoes
Slow (high-cost)	32.8%	20.3%	40.3%	28.5%
Medium	33.1	19.6	40.5	28.8
Fast (low-cost)	32.7	19.7	39.4	29.7

Profits in Retail Stores, Classified on Basis of Stock Turn
(Expressed as Percentage of Net Sales)

Stock Turn	Department Stores	Groceries	Jewelry	Shoes
Slow (high-cost)	0.8%	0.6%	0.2%	−2.1%
Medium	1.3	2.0	1.4	1.4
Fast (low-cost)	2.5	2.3	3.5	4.0

7. *Wholesaling may be thought of as essentially the assembly (buying) phase of merchandising, while retailing is essentially the demand manipulation (selling) phase.* This is indicated by the following summary of expense items:

Most Common Buying and Selling Expenses
(Expressed as Percentage of Net Sales)

	Expenses of		Ratio S/B
	Buying	Selling	
Retail:			
Drugs	3.9%	13.3%	3.4
Groceries	2.3	7.9	3.0
Hardware	4.4	7.0	1.6
Jewelry	6.6	14.9	2.2
Shoes	4.6	13.1	2.9
Wholesale:			
Automotive equipment	13.5	8.9	0.6
Drugs	7.9	3.8	0.4
Groceries	4.5	2.9	0.6

8. *Salaries and wages constitute the most costly item in retailing,* with rent generally second, interest third, and advertising fourth. The following examples show the importance of these items relative to total operating costs:

Proportion of Total Operating Costs Spent for Various Purposes

	Department Stores	Groceries	Jewelry	Shoes
Salaries and wages.......	54.0%	60.0%	54.0%	54.0%
Rent....................	10.0	7.5	12.0	13.0
Interest.................	6.5	6.0	13.0	10.0
Advertising.............	10.0	2.0	6.0	8.0
Delivery................	4.0	7.0	0.0	0.8
All other................	19.5	18.5	15.0	14.2
Total...............	100	100	100	100

9. *Rent absorbs from a low of 1.3% of the consumer's dollar* in the case of groceries to a high of 5.0% in the case of jewelry. As indicated by these figures, there is little opportunity for the consumer to save money by trading in a "low-rent district." For example, rent constitutes, on the average, 3.5% of sales in retail shoe stores. If an individual store management should reduce this by one-half, the saving would be only 8.5 cents on a $5 pair of shoes, 17 cents on a $10 pair, or 35 cents on a $20 pair. In no case would it be sufficient to constitute a strong patronage motive. Similar conclusions are inevitable in each retail line.

10. *Cash-and-carry grocery stores show a saving in operating expenses* compared with stores giving charge and delivery service, equal to 4% of the consumer's dollar, according to a special survey made by the Harvard Bureau of Business Research in 1924. Of this 4% saving, approximately 3.5% was passed on to the consumer in the form of lower prices, while 0.5% was retained as greater net profit by the cash-and-carry merchants. Thus it seems that prices must be lower by 10%,

or thereabouts, if consumers are to be persuaded to pay cash and to carry their bundles home.

11. *The size of the usual purchase by consumers has much to do with the percentage of the consumer's dollar which is absorbed by retailing costs.* It has been found that the city dealer's margins on fruits and vegetables vary all the way from 37% of selling price with potatoes to 63% with onions. A considerable part of this variation appears to be due to differences in the relative size of purchases by consumers. When the retailer's margins were figured on the *average sale* for each commodity, they were found to vary only as between 9.2 cents and 10.9 cents per sale. When the unit sale is small, the percentage margin must be large in order to give an adequate gross profit per sale. This suggests that one reason for the general increase in marketing costs is the growing tendency for consumers to buy in smaller quantities.[8]

The same conclusion is inescapable in the wholesale field when smaller orders are delivered to retailers. A recent study of the differences in costs of wholesaling drugs in full-case or broken-case lots illustrates the point clearly. For example, assume that an article sells for $10 a case of one dozen units, or $2.50 per quarter-dozen and 84 cents per unit. The general handling and financial expenses of selling this item in 1/12 dozen, ¼ dozen, or full-case lots would be approximately 19.68%, 9.91%, and 5.70% respectively.[9]

This reduction of expenses relative to sales, as the size of the sale increases, appears to hold true generally. It results from the fact that certain movements and operations must be performed regardless of the amount of the sale; the sale must be recorded, the goods must be handled, either cash payment must be accepted or a charge entered, and so on. In fact, when goods are sold in broken-package lots, some handling is required which would not be necessary if all sales were made in the original packages as they come from the factory. One possible method of reducing marketing costs is suggested by these examples, and the Wholesale Druggists Association is undertaking a campaign to accomplish this result.

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[8] H. D. Comer, "Analyzing the Variability of City Dealer's Margins," *Journal of Farm Economics,* Vol. 8, No. 2, p. 254.

[9] H. J. Ostlund, Bul. No. 7, National Wholesale Druggists' Association.

Failure as a Cause of High Costs.—Each year from 1922 to 1928 inclusive, an average of 16,000 marketing firms failed in the United States. The total liabilities averaged not less than $300,000,000 per year.[10] This means that some operators are forced out of business each year, that trade channels and established relations are broken down, and that inefficiency must be fairly common at all times.

The firms which fail and pass out of the picture are almost instantly replaced by others. This fact is illustrated by studies of the grocery and drug trades in Buffalo, N. Y.[11] In 1918, there were 164 independent drug stores in Buffalo. In 1927, 82 of these stores, or 50%, were still in business. In the grocery business, in contrast, of 1,459 stores listed in 1918, only 242 or 16.5% remained in 1927. But in both cases, for every store which withdrew, more than one was established to take its place. During the nine years, 227 drug stores disappeared and 323 were opened, while with groceries the corresponding numbers were 5,482 and 5,766.

The number of stores out of each 100 organized each year, which may be expected to remain in operation at subsequent dates, is given in the table on page 314, based on the experience in Buffalo.

On the average, 60% of the grocery stores opened each year may be expected to disappear by the end of the year. Newly opened stores constitute from one-third to one-half of the total grocery outlets at any one time. With this constant opening and withdrawing of outlets it is inevitable that there will be great inefficiency and waste of effort. Until it is somehow made more difficult or less popular for inefficient, underfinanced operators to enter the retail grocery field there is certain to be both individual and social loss, for it is estimated that at least 65% of all retail failures result from inexperience and lack of financial support.

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[10] United States Department of Commerce, *Yearbook*, 1929, p. 25.

[11] "The Mortality of Independent Grocery and Drug Stores in Buffalo between 1918 and 1926," *Statistical Survey*, University of Buffalo, Vol. 4, Nos. 3, 4.

Stores Which Will be in Existence at Different Dates After Opening

	Drug	Grocery
1st year	100	100
2nd "	75	40
3rd "	66	26
4th "	58	20
5th "	52	15
6th "	51	12
7th "	48	10
8th "	42	8
9th "	29	7

The figures which have just been presented refer to *independent* retail stores. Modern *chain-store organizations* appear to have much lower mortality rates. This is probably due to more careful choice of locations, more accurate control of merchandise stocks, and more adequate financial support. One important argument in favor of the chain-store method of merchandising is found in the greater stability of individual units, which at present appears to be associated with the method.

Improvements in Physical Handling.—An important element in the effort to lower distribution costs is found on the part of the railroads in reducing transit losses. In every year but one since 1920, the railroads have recorded a decrease in loss and damage claims. In 1923 such claims totaled $49,000,000, while in 1928 they had been reduced to $36,000,000. During the same five-year period the loss and damage claims paid by express companies were reduced from $5,400,000 to $3,200,000.

Factory packing in containers suitable for individual requirements, which has been encouraged by the development of chain stores, also has tended to reduce handling costs. The adoption of specially designed containers for individual shipping conditions has increased the use of mechanical equipment for rapid and cheap handling, both within factories and in transit.

Notable recent improvements have been made in the packing of certain items, such as eggs and furniture. There has also been an increase in efficiency in re-icing and ventilating cars of perishables and in the punctuality of running trains. These are among the factors which have resulted in the lower loss and damage claims. Continued improvement in physical handling appears to be probable, thus reducing somewhat the costs of marketing.

Other Opportunities for Reduction of Costs.—Planning and budgeting, as suggested in Chapter 13, furnish a promising method of reducing marketing costs. One of the most wasteful things in retailing is that retailers assemble large quantities of goods for sale at a planned price, only to find that the trade will not purchase them at that price. As a result, they must be marked down, in which case the expected margin of profit is not obtained and the margin on something else must be high enough to cover the loss. Some mark-downs are expected, to be sure, and are included in the original planning, but this by no means applies to all of them. When they are not foreseen they are the result of incomplete planning and as such they bring about a social loss.

In actual practice goods sell at prices which are materially below the planned figures. For example, it has been found that furs actually sell, on the average, 20% below the price originally set, women's coats 18%, millinery 13%, furniture

10%, men's clothing 9%, shoes 7%, underwear 5%, and candy 3% below the planned price. If buying (the assembly function) could be more accurately fitted to demand, a considerable part of these mark-downs might be avoided. This would lessen uncertainty, as well as reduce the direct expense of remarking goods, changing records, handling slow-selling stock, advertising price reductions, and so on. One principal advantage of group buying is found in the ability of the group to choose goods which are better suited to the store requirements. In this manner, mark-downs are reduced to a minimum.[12]

Orderly marketing, especially with perishable commodities, is effective in reducing certain marketing costs. Waste due to over supply in certain markets at a time when other markets are under supplied may, and should, be reduced through market research, market news, and intelligent market cooperation. The agricultural cooperatives and the trade associations have made splendid starts toward elimination of this particular sort of waste, but their efforts should be carried out more widely and systematically.

The increasing cost of merchandising, coupled with the range in costs which has been found to exist between different institutions in the same line of trade, has done much to bring about new methods of marketing. The institutions and organizations which are developing involve, in most cases, some form of integration or centralization of management and control.

Another considerable opportunity for reduction of the costs of distribution exists in the standardization of commodities. Considerable progress is being made in this direction at the present time.

Changes in Marketing Methods.—An outstanding feature of present-day marketing is the change in methods taking place. In many lines there is a distinct tendency toward more direct methods. There is also a tendency toward large-scale enterprises in marketing, particularly in wholesaling and retailing. Growing competition has undoubtedly been one big factor in the change; another is probably the improvements in transportation and communication. Advertising has also been a factor in the change. For farm products, the large spread between producers' and consumers' prices, and the depression following the World War, have been the cause of inquiries into ways and means of improving marketing methods.

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[12] See C. N. Schmalz, "Studies of Performance in Department Stores," *Michigan Business Studies*, Vol. 1, No. 8; and W. W. Warshawer, in the *American Economic Review* (*Supplement*), March, 1929, p. 39.

On all sides there is evidence of a search for more efficient, less costly methods of distribution. This search has led to the establishment of new types of outlets for goods. It has also led to centralized control of merchandising operations, sometimes in the hands of manufacturers, sometimes in those of merchants and sometimes, even, in those of consumers. As a result, the intensely individual competition of a few years ago is giving place, in part, to joint action and standardization of commodities.

The next several chapters discuss these new developments. Concentration and integration in marketing; cooperation, both among producers and among consumers; standardization and simplification of lines of commodities; the activities of trade associations and of government; each of these movements represents an effort to lessen the costs of marketing and, thereby, to enhance the scale of living. Some idea of the present status and possible future accomplishments of these movements may be found in the following pages.

CHAPTER 19

CONCENTRATION IN MARKETING

Forms of Concentration.—There are three forms of concentration of control in business. These may be designated as: (1) increased output per plant (large-scale production or selling); (2) central-office grouping of plant management (combination); (3) operation of several contributing institutions under one management (integration).

The first of these types is common in manufacturing. It is one of the outgrowths of intensive demand manipulation and it generally results in lower costs. Without question, the development of large-scale operations has helped to bring many manufacturing industries to their present high levels of efficiency.

This particular type of concentration of control does not seem to have reduced costs in merchandising, however. As pointed out in the previous chapter, unit grocery and clothing stores commonly have the lowest operating expenses in proportion to sales when the volume of sales is under $100,000. Apparently it costs relatively more to increase sales beyond $100,000 per store than it does to build up and hold that volume of trade. With most forms of marketing units there seems to be a limit, reached rather soon, beyond which the costs of marketing take an ever-increasing part of the consumer's dollar.

The second and third forms of concentration of control, on the other hand, are frequently found in marketing as well as in manufacturing. It appears that they generally result in reduction of costs in both activities. In fact, combinations and integrations are among the outstanding developments in the recent attempts to improve the efficiency of distribution. For example, chain stores, with a number of decentralized units managed from a central office, are typical of concentration through combination. Manufacturers' retail branches involve both combination and integration in that they are a group of retail stores under one management and also, the sales organization of the manufacturer, the wholesaler, and the retailer are all under one general head. In neither of these cases does the size of the marketing unit increase beyond the point of efficiency suggested above. There is centralization of management, but not of physical operation.

Department stores are examples of large-scale retail units. Their costs are high as compared with those of smaller stores. However, they take advantage of many features of integration, making direct contacts with manufacturers and sometimes even controlling their sources of supply. Without this development of integration the costs of marketing through them would be even higher than they are. Moreover, there are recent combinations of department stores into chains, which give some of the advantages of central-office standardization and control as well.

Thus combination and integration are the forms of concentrated control of merchandising to which we may look for improvements and lowered costs.

Some Reasons for Integration in Marketing.—One explanation for the development of integration in marketing is easily found. Manufacturers' branches furnish a more aggressive sales organization for a specific commodity than do the more ordinary channels. Therefore, they tend to increase sales of a particular commodity. This, in turn, may decrease manufacturing costs. If selling costs are not increased proportionally, business flourishes—for after all, it is the cost at which the goods can be sold to consumers which is important.

Moreover, there is a close dependence between primary production and marketing, and a balance must be maintained in their relations. Manufacturers can plan their outputs more accurately if they know definitely through what retailers they will sell. Similarly, wholesalers can control their stocks more nearly in keeping with demand if they are supplying completely a definite group of retail stores.

There is also a personal side to integration. Lack of proper adjustment and balance in individual businesses is not surprising in view of the fact that the average business exists because its founder or leader is a specialist. Whether he has capitalized his buyer's instinct for values, his salesman's tact and enthusiasm, or his ability and patience as a shop organizer, he is likely to depend upon this talent too exclusively. Integration permits cooperation and balance between experts, each one devoting his energies to his specialty.

Concentration in Marketing Under Two Sets of Circumstances.—The importance and the effect of concentration in marketing depends, in part, on the form it takes. Whenever there is integration, there is a harmonizing of the interests of the manufacturer with those of the merchant. This tends to decrease market risk, by making the plans of the several units in the chain of procedure known to each. Manufacturers know what stores will handle their goods and merchants know the production program of the manufacturer.

With chain stores and department stores, on the other hand, the contact with the producer is not as close as in cases of more complete integration. The scale of manufacturing may, or. may not, be increased by the growth of the chain, depending upon the buying policy of the central office; the management may prefer to patronize several small manufacturers rather than one large one. Moreover, the manufacturer's uncertainty as to next year's sales—or even next month's—is not removed to the same extent, because chains and department stores will change their source of purchase whenever it is to their advantage to do so. The advantages of concentration in marketing depend in part, therefore, upon the closeness of relationship between the production and the merchandising fields.

Examples of Integration.—Attention has been called several times to the fact that the marketing of industrial goods and of consumer goods involves different problems; these problems must be differently met, both because the goods are dissimilar and because the clientele are entirely unlike. That portion of industrial marketing which deals with raw materials is likely to be on a large scale, because the use made of the materials by industry is on a large-scale basis. This is especially true of the mineral raw materials. With agricultural products, even when they are industrial raw materials, such as cotton and wheat, the small-scale production necessitates small-scale marketing in the early stages. Later in the marketing process, huge terminal elevators and other large-scale units come into play even for these commodities. The illustrations of integration and other forms of concentration of marketing discussed in this book will, however, be limited mainly to consumer goods, goods which have already gone through their final commercial processing.

A. Manufacturer-Wholesaler Integration.—

1. WINCHESTER-SIMMONS Co. At the close of the late World War the Winchester Repeating Arms Co. decided to undertake the manufacture of fine tools, cutlery, skates, fishing tackle, and other specialized hardware lines on a large scale. In 1919, it announced its intention to discontinue sales to wholesalers, to operate a chain of retail stores in cities of over 50,000 population, and to give exclusive agencies to hardware retailers in cities under 50,000 population. For a time this method of distribution seemed entirely satisfactory, but with the steady increase in the number of agencies, the Winchester

Co. found that its distribution facilities were inadequate to give prompt service to all its retailers. An exclusive agent in a middle western city might be 400 miles from the nearest Winchester warehouse, and just around the corner from the nearest competing wholesaler. Under such conditions the retailer would sometimes discard Winchester goods, in favor of those which could be obtained more promptly from the local wholesaler. The Winchester Co. found that if it was to perform the wholesale functions satisfactorily it must serve its retailers from conveniently located warehouses. In order to meet this situation, it combined in June, 1922, with the Simmons Hardware Co. This latter company maintained warehouses in all of the principal cities in this country; it had built up distributing facilities abroad; and it enjoyed a favorable reputation as one of the largest hardware wholesalers in the United States.

For a few years, this combination seemed successful in the integration of the manufacturer's and wholesaler's activities. In 1928, however, the executives decided that the scheme would not work, so that now the Winchester Company is manufacturing and the Simmons Company is wholesaling, somewhat as they did before the original merger in 1922.

During the same period the Remington Arms Co., which had gone through an almost identical production expansion since the war, continued to distribute through wholesalers, apparently with success. The Remington Co.'s contentions as to the necessity of the jobbers were as follows:

Employment of the wholesaler reduces the cost of distribution and, therefore, the cost to the ultimate consumer. The wholesaler sells many lines of goods, so that his selling costs are widely distributed. If a manufacturer selling a limited line of goods were to attempt to cover the entire United States with his salesmen, his distributing costs would be unduly high. The wholesaler reduces losses from bad debts because he deals in a restricted area and can, therefore, keep in touch with business conditions. The wholesaler is a convenience because his capital and his storage facilities make it possible for the retailer to get goods both quickly and in small quantities.

The experiences of these two concerns have not been conclusively in favor of either method. They do seem to have emphasized one possible weakness of manufacturer-wholesaler integration, however. Unless the line manufactured is sufficiently broad to stock almost completely the retail outlets and thus justify conveniently placed wholesale depots, competing wholesalers are likely to break down the exclusive-agency arrangements.

2. United Drug Co. Some twenty-five years ago, L. D. Liggett effected an exclusive agency chain arrangement between the United Drug Company and the Rexall Stores, which was essentially similar to the Winchester plan. The United Drug Co. was a general manufacturer of proprietary medicines and medicinal supplies. The retail Rexall Stores were local institutions and remained so; but on taking the Rexall agency they became members of a loose organization which had a voice in the management of the United Drug Co.

This scheme proved successful from the start. Much of the early success was due to the unqualified guaranty of high quality merchandise, which was given at a time when patent medicine and "cure-alls" were rampant.

In March, 1928, the United Drug Co. was combined in control with several other manufacturers, under a holding company known as Drug Incorporated. This combination now has control of the production of nearly all the goods sold in the Liggett and the Rexall stores.

Beginning in 1928, the McKesson-Robbins Co., another drug manufacturer of national repute, has acquired a chain of successful wholesale drug concerns. Apparently, this new organization is operating along much the same lines as laid down by the United Drug Co.

3. Agricultural Cooperatives. The agricultural distributive cooperatives represent a partial integration of producer-wholesaler functions. These organizations are described elsewhere.[1] It is only necessary here to call attention to the fact that, in the cases of the Burley tobacco growers and the Texas Cotton Association, at least, they sold much of their product directly to manufacturers, without the intervention of other middlemen.

4. Shoe Manufacturers. Nearly all shoe manufacturers have taken over the wholesalers' services and are selling directly to retailers. Sometimes they sell to exclusive retail agencies, sometimes to general shoe retailers. To a large extent, they have eliminated the wholesaler as a distinct organization.

This does not necessarily mean that the wholesalers' functions have been avoided. The fact of the matter seems to be that improved transportation facilities, more adequate financing, and better stock control on the part of retailers have permitted more frequent purchases from the manufacturer, without the requirement of wholesale storage previously resorted to. Credit risks have been held within bounds by careful selection of retailers. In the case of shoes, and some similar lines, a single manufacturer handles practically as diverse a line as a wholesaler would, so that selling costs are as widely distributed as they would be without integration. The special advantages would seem to be an assurance of specific retail outlets, and an opportunity for more aggressive selling.

5. Meat-Packers. In the meat-packing industry the large packers maintain branch houses which perform the wholesale functions. For example, Swift & Company sells perishable meats and dairy and poultry products direct to some 200,000 retailers in all parts of the United States. The marketing of the company's products requires approximately 6,000 refrigerator cars. These cars carry products from the surplus-

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[1] See Chapter 20.

producing regions in the Middle West to the areas of deficient meat production in the East, the South, and other sections. An essential part of the company's equipment is its nation-wide marketing organization, consisting of more than 400 refrigerated branch selling houses and over 600 car routes.

There are important reasons why Swift & Company maintains its system of branch selling houses:

1. Fresh meats are perishable and must be marketed quickly. Delay is caused by unnecessary handlings, but when meats remain under one ownership during the whole marketing process, unnecessary handling is eliminated. The company must also keep in close touch with retail demand. Demands change quickly in various markets; hence, it is necessary—in order to prevent gluts and shortages—to keep in touch by wire with branch house managers.

2. Extensive and economical branch house operations are possible only because Swift & Company sells a wide line of related products. In addition to fresh meats of all kinds, the branch sells cured meats, sausage, poultry, butter, eggs, cheese, lard, vegetable shortening, oleomargarine, and other food products. These products add to the total volume of business and enable the company to do a better job of supplying retailers.

3. Branch house operations can be performed economically only when there is a large volume of business. The company is able to put such a large volume of business through each individual branch house that unit selling costs are kept at a minimum. Furthermore, it is able to supply each community with the type and quality of meat products its people demand. Each branch house can draw upon the production of any one of the company's numerous producing units. The company can find heavy beef to supply the demands of New England and light-weight cattle for Philadelphia; can furnish bacon of light averages for Northerners and salt pork from heavy hogs to meet the special demands of still other markets.

The branch houses provide a direct and economical method of marketing the company's perishable products. They are distributing units, well able to supply the varied demands of thousands of retail stores. They provide the indispensable refrigeration facilities so necessary to the proper marketing of meats. Through their delivery systems they make frequent deliveries to individual stores. The wide line of products handled and the large volume of business reduce selling costs to the minimum.[2]

The average cost of the meat packers' branch house service is less than 5% of sales, which makes it one of the lowest-cost wholesale businesses in the country.

Central office management of a chain of wholesale establishments, which are closely allied to the producer, has, in this case, resulted in a high degree of efficiency, relative to general wholesale practice. This experience at least suggests that further concentration of management in wholesaling and its integration with manufacturing may be productive of substantial economies.

B. Manufacturer-Retailer Integration.—Browning, King and Company, of New York and other cities, are a simon-pure example of the growth of a chain from a single store. Nowhere along the line has the development been attended by exclusive agencies. The company manufactures men's clothes, and sells them through its own stores, making its appeal to the public on the basis of a maker-to-user economy.

The manufacturer's retail branch has a peculiar merit in a business like clothing or shoes. The manufacturer can almost completely control his output; that means that as a retailer he is able to avoid being "short" or "long" on any line, and that his risk is correspondingly reduced. Trade demands are carefully calculated in advance, and orders for raw materials are placed accordingly. With both fields, manufacturing and retailing, under its eye, the management is able to trim its sails quickly and precisely. Moreover, in these lines a single manufacturer can almost completely stock a retail store with his own products. This is far less feasible in the hardware and grocery trades.

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[2] Adapted from Swift & Company, *Annual Yearbook*, 1929, pp. 24–30.

A new development, which may make manufacturer-retailer integration not only possible but actual in the grocery field, is taking place with astonishing rapidity. During 1928 and 1929, at least three groups or combinations of food manufacturers have been formed, each with enough subsidiaries to furnish nearly a complete stock for a retail grocery store. Standard Brands, Inc. is the name selected for the new company resulting from the consolidation of the Fleischmann Co. and the Royal Baking Co., with their several affiliations. J. P. Morgan & Co. is sponsor for this group. General Foods Corporation is an outgrowth of the Postum group of manufacturers and now has a very complete food products line, including full rights to the Birds-eye process and apparatus for processing various foods. The United Stores, Inc. are definitely entering the field of food retailing, while at the same time they have established very close relations—if not actual combinations—with a group of manufacturers, including the Corn Products Refining Co., Gold Dust Corp., National Dairy Products Co., Standard Milling Co., and so on.

These developments suggest the possibility of manufacturer-retailer integration on a large scale, with three or four strong vertical trusts competing for consumer patronage through their own retail stores. As yet, however, the combinations are selling through the established retail channels, both independent and chain. Their marketing economy results from their ability to distribute a line of products through a single sales organization, thus adding to the number of items handled by each salesman.

C. Wholesaler-Retailer Integration.—

1. Department Stores. The department store is a product of the growth of cities. Roughly, 15% of all the retail business of cities is done by department stores.[3] Probably 10% of all the retail business of the country is done through department stores. It is estimated that there were about 2,000 department stores in the country in 1927, some 500 of which had sales of $1,000,000 or more each. R. H. Macy & Co. of New York is reported to have sold over $90,000,000 of goods in one recent year.

Lord and Taylor's of New York is possibly the oldest existing department store in the world. It was organized in 1826. Other representative stores were started as follows:

Jordan Marsh, Boston, 1851.
R. H. Macy & Co., New York, 1858.
Wanamaker's, Philadelphia, 1861.
T. Eaton, Toronto, 1869.
Marshall Field, Chicago, 1881.

In a large measure department stores buy directly from manufacturers, thus absorbing the wholesalers' functions and obligations. To a growing extent, groups of department stores maintain cooperative or joint buying offices in the main market centers, such as New York and Paris. Often such a buying group—or the larger department stores on their own account—purchase the entire output of a manufacturer. In such cases they may suggest, or even dictate, production policies as to quantity and quality of output. In this way they are able to make production coincide with demand in the same direct way as does the manufacturer's retail branch organization.

2. Mail-Order Houses. The two largest mail-order houses in the United States—Sears-Roebuck and Montgomery Ward—had combined sales in 1928 of almost $500,000,000.

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[3] *Survey of Retail and Wholesale Trade of Eleven Cities,* U. S. Department of Commerce, 1927.

In 1928, Sears-Roebuck sent out 11,000,000 catalogues of 1,200 pages each. The printing of these catalogues required 90 tons of ink.

Mail-order houses buy and store like wholesalers, but they sell in small units, as retailers, thus integrating the activities of the two. Their purchases are so large that they often take the entire output of manufacturing plants, as do the department stores. In fact, their goods are so highly standardized that they are able to enter into more contracts with manufacturers than can department stores, and often for a longer period.

Recently, the mail-order houses have adopted a policy of opening retail stores in many communities. This seems to be a result of a change in the shopping habits of consumers, which has developed with the advent of the automobile and good roads. As this development continues, the mail-order house of the past will become more and more like the chain store, which is the best example of central-office grouping in merchandising.

3. Chain Stores. Chain stores furnish typical examples of centralization of management of many individual units. They also are illustrations of integration because they combine wholesaling and retailing under one management. Some of the chains have attained huge total sales; the Great Atlantic and Pacific Tea Company is said to have reached sales of nearly $900,000,000 annually. The volume of commodities sold over the counters of this chain is awe-inspiring. For example, in 1924, it sold 75,000,000 pounds of coffee, 80,000,000 pounds of butter, 380,000,000 dozen eggs, 23,000,000 pounds of flour, 400,000,000 pounds of sugar, 300,000,000 pounds of potatoes, and 325,000,000 cakes of soap. It had 37 warehouses, 13 bakeries, 10 coffee-roasting plants, and 35 manufacturing and canning plants.[4]

The Atlantic and Pacific Tea Company is not an illustration of large-scale retailing, however, in the sense of large total sales from a single plant. The $900,000,000 sales are made from 18,000 stores, or an average of $50,000 per outlet. This is typical of chains in general. Moreover, many chains have no larger volume of business at wholesale than do competing wholesale establishments. Whatever advantages chain systems possess would seem to come largely from centralized management and integration of processes, rather than from the scale of operations.

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[4] P. White and W. S. Hayward, *Chain Stores*, p. 492.

The survey of the Department of Commerce in 1927, referred to above, indicated that about one-fourth of all retail business was done through chains. This represents a sharp increase over a few years previously. In the 1926 edition of Poore's *Manual of Industrials,* 100 chain store companies were listed, with their dates of incorporation. The following table, based on the above source, emphasizes the comparatively recent development of chain merchandising:

Chain Stores Grouped by Dates of Incorporation

Before 1890	5 chains
1891-1900	6
1901-1905	12
1906-1910	11
1911-1915	16
1916-1920	23
1921-1925	27
	100

Chain stores have been thought of as confined primarily to the sale of convenience goods, especially groceries. There are, however, five trades where the percentage of total retail outlets in chains is greater than in the grocery trade, namely, the variety stores, gas and oil stations, men's hat and cap stores, boot and shoe stores, and automobile dealers.

The following table covering a few trades, shows the percentage of the total establishments which belong to chains and the percentage of the aggregate retail business which they did in their respective lines:

CHAINS

Kind of Store	% of all Stores	% of Total Sales
All stores	15.1%	28.7%
Automobile	25.1	31.3
Auto accessory	8.2	19.3
Boot and shoe	27.3	51.8
Cigar	11.6	35.5
Men's clothing and furnishings	12.3	19.0
Women's clothing	14.7	15.6
Department stores	13.6	33.0
Drug stores	11.8	29.9
Fruits and vegetables	15.7	9.5
Furniture and house furnishings	13.6	32.8
Gas and oil station	46.4	73.5
General	14.7	29.7
Grocery and delicatessen	21.0	41.3
Hardware	14.6	9.2
Hat and cap, men's, boys'	33.7	51.7
Millinery, artificial flowers	20.4	36.9
Variety (e.g., 10¢ stores)	55.1	70.7

It will be noted that in practically every trade the percentage of business done by chains is larger than the percentage of total outlets which are in chains. This means that the sales per outlet are larger than for independent stores. Even so, the average sales from chain units are hardly equal to the most efficient size, as determined by the studies reported in the previous chapter.

A more important consideration, however, is found in the fact that 88% of the independently owned stores do less than $50,000 worth of business annually; in groceries, fruits and vegetables, cigars, gas and oil stations, and millinery, 95% of the stores have sales of less than $50,000 per year.

"The real significance of these figures and their bearing on the chain store problem is apparent when they are translated into terms of net profits. A store doing $50,000 worth of business a year is doing less than $1,000 gross business a week. At a net profit of 2½% (which is about all that can be expected in a competitive trade where the turnover is reasonably rapid), this represents about $23 a week net profit. A generation ago it was possible for a man earning $23 a week, net, to be quite a substantial person in an ordinary community; he could be a master in his lodge and a deacon in his church; and economically and socially he was on a par with all except a few of the people of the town. But during these years practically all wage-earners have been able to enforce an increase in their compensation so that the daily earnings of men of many crafts represent at least half of this $23 a week net earnings from a store. If the carpenter, and the plasterer, and the plumber, and the electrician can, in two days, earn as much as the storekeeper can in six, it is obvious that the storekeeper must change his method of doing business so as to increase his aggregate income or he must give way to some other form of organization able to do business on this narrower margin of profit."[5]

In contrast, the department store, mail-order house, and chain store do enough business so that a central office management of highly competent men may be employed to direct the activities of the store. Methods of layout, budgeting, and control are planned and installed, so that the $23-a-week man in charge of a branch or a minor department is at a decided advantage over a man with the same ability in an independent store. The full benefits of specialization may be reaped in this way.

4. Group Buying. Many of the independent stores have entered into group buying plans of various sorts, especially in the grocery and drug fields. A study by Professor W. L. White of Texas, indicated that the group organizations which performed the full functions of the so-called service whole-

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[5] P. T. Cherington, address in Chicago, December, 1928, N. A. T. M. A.

saler did so at an expense of 6.9% of sales, as compared with 10.6% for the service wholesalers, or a reduction in wholesale expense of 3.7% of sales. About half of this reduction appears to result from lower selling costs and credit losses, while the balance is largely a shifting of costs from one group to another, rather than a real social saving.[6]

Group buying does, in many cases, give the advantages of integration between manufacturer and retailer. It may, also, permit a comparison of methods of operation, layout, display, and so on, as well as a degree of cooperative advertising, to the advantage of the individual retailer.

These groups of independent retailers are sometimes called "voluntary chains" to distinguish them from the "regular" chains in which there is centralized ownership. Voluntary chains are composed of retailers, or of retailers affiliated with wholesalers, organized to procure the competitive advantages inherent in the chain type of merchandising organization. The advocates of the voluntary chains claim that they combine the advantages of improved planning and buying which the regular chains enjoy, with those of private ownership. Among the latter is said to be the greater interest of the owner-manager in his clientele and in the problems of the community in general.

Voluntary chains are stronger at present in the grocery field than elsewhere. In 1929, it was estimated that there were in the neighborhood of 350,000 retail grocery outlets in the United States. Of these, approximately 75,000 were units of regular chains, while 55,000 were affiliated with voluntary chains. In general, the voluntary chains have shown the greatest development in territories where regular chains also are strong.

Several types of voluntary chains exist. Some of these may be illustrated by groups at present operating in the Twin Cities.

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[6] W. L. White, *Cooperative Retail Buying,* Harvard Bus. Rev., 1928, Vol. 7, No. 1, p. 64.

1. Minneapolis Allied Grocers, Inc., is a retailer-owned wholesale company, operated on a cooperative basis, with the profits distributed to members in proportion to their patronage. Members are allowed to purchase goods from other wholesalers, but they are required to report immediately all cases in which they can purchase at lower prices than through the cooperative organization. There were about 80 members in the Twin Cities in 1929.

2. The Community Stores are a group of 150 retailers loosely affiliated with the Jordan-Stevens Co., wholesaler. This type of local wholesaler-retailer affiliation is generally initiated by the wholesaler. The latter hopes to gain through assured volume of sales of staples and nationally advertised lines, controlled outlets for private brands, and lowered operating and selling expenses. The retailer receives lower prices through pooled buying power, supervision of merchandising technique by wholesaler-hired experts, and the prestige of the group.

3. The Independent Grocers' Alliance, with Winston and Newell Co. as their Twin Cities wholesaler, and the Red and White Chain, with Slocum-Bergren Company as wholesaler, are two examples of national wholesaler-retailer groups represented in the Twin Cities. These national groups all tend to stress private brands, and some of them are becoming so large that they may undertake to advertise nationally in competition with such regular chains as the "A. & P." In 1929, the I.G.A. reported 50 wholesalers and over 8,000 retailers. In the I.G.A. organization, the retailers agree to buy a specified minimum proportion of their merchandise from the official wholesaler, to modernize their store, and to follow headquarter's directions concerning merchandise methods and control. The Red and White system has, probably, the closest relationships between manufacturers, wholesalers, and retailers of any voluntary chain. Retailers must buy *all* merchandise from the Red and White wholesaler, except produce and other

lines not stocked; the expressed ideal of the group is to do the largest possible percentage of business in private-brand goods.

These groups are among the largest factors in grocery distribution in the Twin Cities.

Present Indications.—Without doubt, the rapid development of centralized control of merchandising operations is bringing greater intelligence to bear upon distribution problems. The less efficient of the independent operators are already fading from the field. Central-office management for certain purposes, such as buying, cooperative advertising, research, and control, is certain to supplant individual effort in many cases.

For purposes of contact with the customer, on the other hand, the owner-proprietor of the medium-sized store is likely to retain an advantage over the low-salaried employee of a corporation. Some scheme which combines the two things, such as an ownership interest on the part of the unit manager, would seem to be a logical solution.

In the meantime, the example set by the chain stores has done much to improve the methods used by the independent merchants. Greater attention is being given to stock control, to careful buying, to improvement in store layout, and to the general avoidance of waste. Among the affiliated independent stores these improvements are especially notable. The situation is decidedly in a state of flux at present, but it seems probable that a degree of independent ownership will remain in retailing for some time to come.

CHAPTER 20

AGRICULTURAL DISTRIBUTIVE COOPERATION

Cooperation as a Mode of Business.—A cooperative society is a voluntary association of persons, with equal responsibilities and rights, organized for the purpose of carrying on a *joint economic enterprise* in accordance with economic principles.[1] It is a separate and distinct type of business organization. It may be set up either as a partnership or as a corporation, although it differs from the ordinary forms of these organizations in many important particulars, both legal and economic.

Cooperative societies differ legally from other partnerships and corporations because in most states they are able to incorporate under special cooperative marketing laws which define the status and scope of such organizations. Moreover, under the Capper-Volstead act the anti-trust laws of our Federal Government do not apply to cooperative organizations with the same rigor as to other business enterprises.

The principal economic differences arise from the facts that cooperative associations get their business from members of the organization and that the gains or profits which accrue are distributed in proportion to the amount of business furnished by each member. Generally, the cooperative association exercises no such control over production—either as to quantity or quality—as do other corporations, although they may perform the functions of standardizing and grading. A related point of difference is that the dividends which are paid to stockholders in an ordinary corporation are earnings on capital invested in stock, while the payments made to members of a cooperative association include earnings on capital invested in the farm, expenses of operating the farm, and wages of management.

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[1] Federal Trade Commission, *Cooperation in Foreign Countries*, p. 17.

Cooperative associations may, therefore, be said to be distinct types of business organizations. They are of interest in a study of marketing chiefly because of the modifications which they introduce in the performance of the marketing functions, and also because cooperation has often been heralded as the "open sesame to bring prosperity to an otherwise down-trodden industry." Like all business organizations, their objective is to make financial gains for their members or owners. The possibilities of gains resulting from the particular activities of cooperation are discussed in later paragraphs.

Cooperative organizations are found today in almost every phase of business activity. In Europe, consumer societies, agricultural marketing associations, credit societies, housing and lighting associations, and many other types of enterprise are operating on a cooperative basis. In this country, the development has been most pronounced in farmers' marketing associations, although many other forms of cooperative effort have been undertaken to some extent.

The Philosophy of Cooperation.—In a highly competitive society each producer is a small man in a big world and is competing with every other producer in an effort to sell goods. If enough of the producers form an organization and combine their forces in the control of supply, they may be able to dictate prices and terms to the less well-organized consumers. Such collusion on the part of sellers has generally been condemned in no uncertain terms in American government. As has already been pointed out, however, cooperative associations are one form of combination encouraged by both state and national governments. The aim of the cooperatives is to increase the returns to members, and attempts to enhance the price are commonly undertaken for this purpose. Control of supply is one method of raising prices which not only has been used by agricultural cooperatives, but which has recently been officially urged upon them by the government through the Agricultural Marketing Board. The ability of cooperative organizations to control supply and to make gains for its members comes largely from the large-scale and integrated operations which their form of organization makes possible.

The fact that control of supply and partial dictation of prices can come from a *cooperative* combination just as it can from any other form of business organization of like size has led some writers to condemn cooperation. "Only free competition is right; cooperation is, prima facie, wicked. Cooperation is only a pleasant name for combining to take advantage of your customers, or of the dealers of whom *you are customers.*"[2] The practical safeguard—and the thing which distinguishes cooperative efforts at control from those of corporations—is the difficulty of holding together the large number of small producers which would be required for effective control of supply.

If free competition is accepted as the ideal situation, cooperation in any particular line of endeavor can be justified only where it is used to overcome an existing inequality in competition. For example, cooperation in agriculture might be justified if it overcomes the inequality in bargaining power between innumerable scattered producers, on the one hand, and large-scale buyers, on the other. Labor unions—cooperation between laborers—are justified in part if they reduce the inequality in bargaining power between employers and employees. Consumer cooperation might be justified because of the lack of cohesion, of bargaining power, and of opportunity to obtain full and accurate information, which exists among consumers as a class. Cooperation in other fields, however, such as the formation of corporate trusts or manufacturers' associations, where big units already exist, might merely aggravate an existing inequality between large-scale manufacturers and small-scale consumers.

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[2] F. M. Taylor, *Principles of Economics*, p. 28.

This chapter, dealing with agricultural distributive cooperation, and the following one on consumer cooperation, will present the facts of cooperative development. From these facts an opinion may be formed as to the justification for, and the probable future of, the several movements.

Purpose of Cooperative Marketing Associations.—The fundamental purpose of cooperative marketing organizations is therefore to make gains for the members. Agriculture is characterized by a large number of small producing units. The output from any one farm is, therefore, an insignificant portion of the total. Individual marketing by the producers is often inefficient. When a large-scale organization does not exist, there is no uniform system of grading or packing; handling and storage facilities are often inadequate so that the market is frequently glutted during the harvesting period; inadequate financing may prevent marketing at the most desirable time and place; market information and market analysis are beyond the scope of the individual producer with the result that marketing may become haphazard; the function of demand manipulation often is inadequately performed; and the bargaining power of the seller is usually too ineffective to insure the best possible returns.

By cooperatively marketing their products, farmers expect to gain by improved grading, packing, storage, shipping, financing, market analysis and demand manipulation. Thus the products may be marketed more nearly at the proper time and place. Better bargaining may put the farmers on even terms with the buyers of their products, market and price information may be gathered, and credit facilities provided. Quality and quantity of the products may be made to harmonize more nearly with demand. Prices may be stabilized by directing the flow of products between markets. Certain development work may be carried on, such as advertising to secure new markets, educating the farmers in production methods, and elimination of competitive wastes in marketing.

In the marketing of grain a considerable degree of improvement and efficiency has been reached through the corporate organization of a trading mechanism, accomplished by merchants and processors. Much the same situation exists in the cotton and the livestock industries. Even in these cases, however, there is opportunity for cooperative organization of farmers in the local markets, in order to provide grading, adequate bargaining power, and sound interpretation of market news at the point nearest the farm. Cooperatives are likely to serve their most useful purpose, however, in trades which are less adequately handled by existing organizations.

In any case, a sound plan of business organization, good management, and member loyalty are needed to bring about the hoped-for gains to members. The cooperative must compete with other firms, already long established, many of which are extremely hostile to cooperative associations. It often happens that a successful cooperative can replace one or more firms which previously handled the farmers' business. Such firms, on the verge of being driven out of business, may resort to all kinds of unfair practices in order to smother the new competition. The California Fruit Growers' Exchange and its forerunners were obliged to fight their way against misrepresentation to the trade and to the citrus fruit growers, both without and within their own ranks. Many other examples, often of unfair tactics, could be cited.

Characteristic Features of a Cooperative Business Organization.—The features which particularly distinguish the cooperative from other business enterprises are:

1. Membership is usually limited to people actively engaged in a certain enterprise. To become a member one must be a producer of the commodity handled; if production is discontinued, the membership usually must be relinquished. Further, a member usually may not sell his shares or membership in

the organization without the consent of the governing board.

2. The amount of capital stock or the number of shares that may be held by any member is usually limited by statute. One member is thus prevented from obtaining financial control of the organization. Many cooperatives have no capital stock, but collect a membership fee in order to raise funds for launching the enterprise.

3. The rate of dividends to be paid on capital stock is ordinarily limited by statute.

4. Each member usually has but one vote, regardless of the amount of stock he may hold. By so limiting the voting power, democratic control of the organization is insured. In other incorporated enterprises the voting is proportional to the number of shares held.

5. There is usually a mutual sharing of the net returns from sales on the basis of patronage, that is, the amount or value of each individual's commodity sold through the cooperative. Record is kept of the quantity and grade of the product received by the association from each member. The product is then pooled by grades, so that advantage may be taken of mass selling.

When the farmer delivers his product he usually gets a certain down payment, which may or may not be equal to the market price that day. At the end of the fiscal period, when the cooperative has sold the products received, part of the proceeds from sales is taken for operating expenses and for contingent reserves. Any balance is then prorated to members on the basis of patronage. As dividends on capital stock are limited in amount, any gains which may come through more efficient marketing and handling by the cooperative are passed directly to the producers in accordance with the share of each in the total sales of the organization.

The final total payment to the farmer is based, therefore, on the following: the average price received by the cooperative for each grade during the pooling period; less the payment made at time of delivery; less the prorated share in operating expenses and reserves.

6. Members are often bound by a contract for a definite period, with or without the privilege of withdrawing from the organization, and are further bound to perform certain acts. The association, in turn, agrees to perform certain definite services for the members. The contract thus defines the terms of operation and the rights of the parties.

A section of the Minnesota General Cooperative Law of 1923 illustrates the above features:

> (a) That the ownership of capital stock herein by any individual stockholder shall not exceed the par value of One Thousand Dollars (\$1,000.00); and (b) that stockholders shall be restricted to only one vote in the affairs of the association; and (c) that shares of stock shall not be transferable except with the approval and consent of the governing board of such association; and (d) that interest shall not be paid on outstanding or paid-up capital stock of the association in excess of eight per cent (8%) per annum; and (e) that the net income of such association, except such amounts as are set aside as a reserve fund . . . shall be distributed only on the basis of patronage.

Types of Cooperative Marketing Organizations.—The results achieved by a cooperative association depend to a large extent upon its organization and scope of operation. The early cooperatives were mostly local; they usually attempted to improve only the local marketing institutions, and did not make contacts in the central markets. In later years, however, the scale of operation of many cooperatives has increased, so that now many are doing a national, or even international, business.

The movement toward large-scale operation has taken two forms, and has resulted in two distinct types of organization. In the first place local cooperatives handling the same product and already established, have federated and set up a new cooperative organization—a central organization, usually with headquarters located at some strategic point. Such an organization is commonly known as the *federated type* of cooperative. Figure 22 illustrates this type.

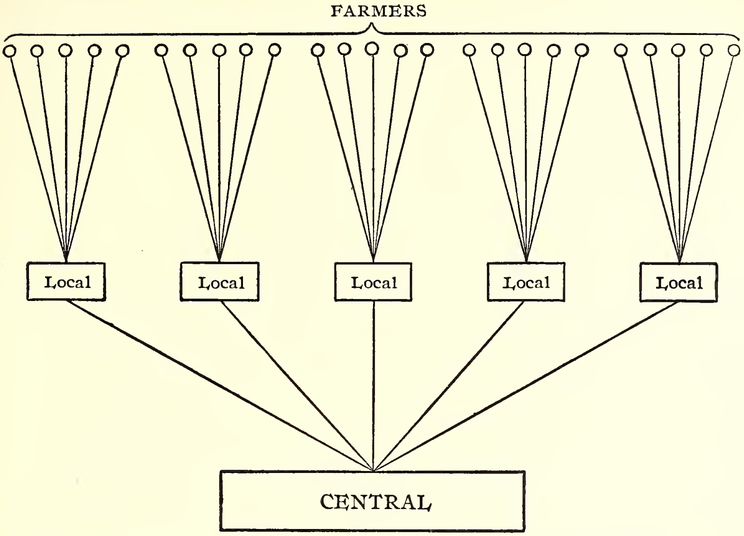

Figure 22. A Federated Type of Cooperative Organization

The producers have no direct dealings with the central organization. The farmer is a member of his local association, and may or may not be bound to that organization by a contract. This local cooperative, in turn, is a member of the central cooperative, and is usually bound to that organization for a definite period of time. Examples of the federated type of organization are the Land O' Lakes Creameries Association, Inc., and the California Fruit Growers' Exchange.

The functions performed by the central organization differ. Sometimes the central directs the selling of the products turned over to it by each local unit, having full authority as to when and where to sell. Thus, the Land O' Lakes organization grades and packs the products, and decides on the time and place of sale. In the California Fruit Growers' Exchange, on the other hand, the central has only advisory powers. Each local organization decides for itself when and where to ship fruit, upon the advice of the central organization. The packing and grading are done by the locals. The central closes the actual sales, carries out the market research, handles damage claims against railroads, carries on educational work among the growers and demand manipulation among the consumers.

The relative merits of centering authority in the local or in the central organization is a question which is beyond the scope of this treatise. Suffice it to point out that either plan has certain merits, depending upon the commodity handled, the extent of competition of private dealers, and other factors.

The second general type of cooperative organization is the so-called *centralized type.* This differs from the federated type in that it is not built up from local units already established. The form of organization is somewhat the same as that of a local cooperative, and differs from the latter only in scope of operation. The local unit takes in only the farmers in a single locality, whereas the large centralized cooperatives attempt to get members from all areas producing the commodity handled. Thus, the southern tobacco and cotton cooperatives attempted to unite all producers of the respective commodities within each state, without first organizing local units. In 1925 the Burley Tobacco Growers' cooperative organization had a membership of over 100,000 built up in this manner. The California Raisin Growers' Association is a centralized type of cooperative, uniting raisin growers into one organization.

Figure 23 illustrates the typical centralized cooperative organization.

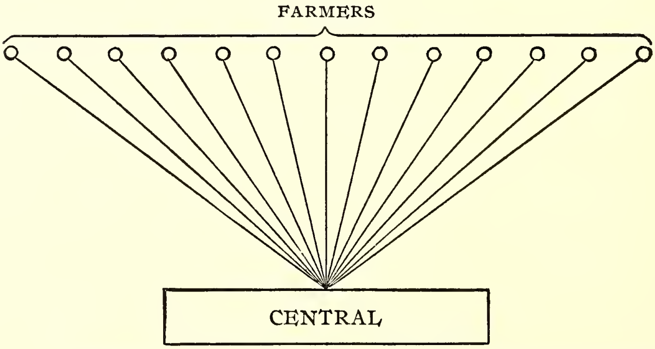

Figure 23. A Centralized Type of Cooperative Organization

The individual producers usually are bound to the central by a contract. The aim is to get all or a majority of the producers of a certain commodity to join the organization, so that a sufficient portion of the crop is controlled to stabilize the rate of marketing, and, hence, prices. The central takes complete charge of the output of members, performs all necessary grading and packing, and determines the selling policies.

The practice is becoming more prevalent today of setting up "dummy" locals in each neighborhood. These "locals" serve only the important purposes of keeping the members in touch with one another, and aiding in research and developmental work.

Large-Scale Cooperatives. Accurate data on the number and status of each type are hard to get owing to the instability of cooperative organizations. Data for 1925 are adequate, however, to point out in a general way the relative importance of the two types, federated and centralized.

"Among the active organizations in 1925 there were about 200 which rank as large-scale associations. All of these served the producers of large areas and most of the associations performed more of the marketing functions than are generally attempted by local associations serving the producers of only a single community or shipping point. About 50 of these large organizations were federations of local units. Most of the federations were serving groups of producers with fruits, vegetables, or dairy products to be marketed. These federations were located principally in California, Florida, New York, and Minnesota.

"There were also 74 large-scale centralized associations at the close of 1925. Of these, 15 were engaged in marketing cotton; 15, grain; 7, tobacco; 4, dairy products; 8, fruits and vegetables; 4, nuts; 10, poultry products; 1 each, broomcorn, cane sirup, and seeds."[3]

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[3] R. H. Elsworth, "Agricultural Cooperative Associations," U. S. Dept. of Agriculture, Tech. Bul. No. 40, 1928, pp. 23–26.

The balance of the large-scale organizations were sales agencies. For example, in 1925 there were 26 such agencies functioning in 20 livestock markets. There were also selling organizations handling grain, poultry and eggs, wool, dairy products, etc.

General-Purpose Cooperatives Not Successful. It should be pointed out that a cooperative organization should be founded to handle only a single commodity or very closely related commodities. Each commodity has its own particular production and marketing problems. Each producer is interested only in his own commodity and can hardly be expected to devote any time to improvements in the status of producers of commodities which are often competing with his own. Hence, the cooperative organizations created to handle general agricultural crops have not met with any measurable success. Membership loyalty will be found chiefly in organizations where every producer is faced with identical problems.

Prior to 1920, many general-purpose associations were formed. These undertook to serve their members in different ways, such as by marketing grain, dairy products, fruits and vegetables, shipping livestock, and buying supplies of fertilizers, feeds, fencing, fuel, etc. Since 1920, the tendency seems to have been to form associations for the purpose of handling but a single commodity, or a few commodities which pass through practically the same channels of trade on the way to the consumer. Separate organizations are frequently formed for marketing dairy products, poultry and eggs, wool, grain, grapes, apples, peaches, dried fruits and vegetables, and separate organizations are sometimes formed to specialize in the collective buying of farm requisites.

Sources of Gain from Cooperation.—It was pointed out above that the primary purpose of a cooperative organization is to make gains for its members. Such gains may come from one or more of five sources:

1. Reduction of Costs. Costs can be reduced in marketing, as in other fields of endeavor, only by more efficient methods. In the case of cooperative enterprises, a larger volume of business than that formerly handled by a private firm may lead to lower costs of operation. The handling of a larger volume of business frequently is accompanied by decreased costs per unit, for at least two reasons, namely: (a) the control of the larger volume permits more accurate adjustment of supply to demand, and (b) the larger unit can obtain the services of managers with greater ability.

In the case of the California Fruit Growers' Exchange, records of operations from 1910 to 1925 show substantial savings at several points. For example, packing costs have been reduced about 10% relative to general prices, and selling costs have been reduced by an equal percentage. These reductions in costs have been effected during a period when market costs in general have been rising and are, therefore, particularly significant.[4]

2. Purchase of Supplies. Many successful cooperatives, the main purpose of which is to market the products of their members, also operate successful departments for the purchasing of supplies. Frequently, considerable savings are possible from the joint purchase of equipment and supplies for processing and packaging the products. For example, the Land O' Lakes organization purchases salt, butter tubs and cartons, cream separators, and so on, for its members; the California Fruit Growers' Exchange is one of the largest purchasers of paper, nails, and box shook on the Pacific Coast and as such it obtains price concessions as compared with smaller purchasers. In fact, the Supply Company affiliated with the C.F.G.E. owns and operates lumbering and sawmill enterprises to insure supplies of box shook to its members. These organizations also purchase farm supplies, such as fertilizer, feed and imple-

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[4] R. S. Vaile, "Some Long-Time Effects of Cooperative Marketing," *Journal of Farm Economics*, January, 1927.

ments, for the individual farm members. The operations of the supply departments are among the important means of reducing costs.

3. Better Bargaining. Cooperative marketing attempts to put the farmer on at least even terms with the large dealers, so far as bargaining power is concerned. Dealers, particularly in the central markets, are at all times familiar with market conditions, and they deal in large quantities. Any single farmer is at a disadvantage in bargaining for several reasons. Often he does not know grades and relative grade values. He usually has not the information to size up new situations in the markets, price trends, or relative values in various markets. Moreover, his output is such a small portion of the total offerings that it makes little difference in the total supply.

By combining, the farmers may exercise greater determination over prices, insuring the payment of full value for the product in accordance with market conditions. With ample credit facilities the crop may be placed on the market in an orderly manner, thus avoiding the break in prices which frequently accompanies haphazard and hurried selling by individuals.

4. Developmental Work. Much has been done by certain cooperative organizations in various lines other than direct selling, such as enlarging the market for their product, educational work with the producers, and attempts to improve marketing conditions.

As an example of *demand manipulation* may be cited the work of the California Fruit Growers' Exchange in developing new markets for citrus fruits. Advertising campaigns have been carried on to educate the public in the food value of oranges and in their variety of uses. Oranges are no longer a Christmas tree decoration for the rich, but are a part of the workingman's diet. Oranges for every pocketbook now find their way into every city and hamlet in the country.

Several things have contributed to the ability of the California growers to bring about this situation. In the first place, California is producing an improved product. The fruit which comes on the market is better in eating quality, better in keeping quality, and better in appearance. These things make for increased sales, both because people like the product better, and because of increased confidence on the part of the trade and consumer.

Moreover, the quality has been still further improved through better standardization and packing methods. An element of guaranty has been introduced through the use of an advertised trade-mark. This gives to a variable orchard fruit an element of uniformity and dependability, the two cornerstones on which to build new business.

Finally, a plan of coordinated selling has been worked out so that markets are not alternately over and under-supplied. Each market is given its share of the supply, as nearly a regular supply as the variable production of an agricultural crop will permit. The development of the Valencia Orange, a variety marketable during the summertime, has aided the regularity of distribution, making it possible for the consumer who once has acquired the taste for oranges to have it satisfied throughout the year.

The California Fruit Growers' Exchange has never considered that its job was ended with the sale of fruit to the jobber. The Exchange helps him sell the fruit to the retailer. Then it helps the retailer sell to the consumer. And finally, it encourages the consumer to buy by showing him how, when, and why he should use oranges. Thus it has hastened sales all along the line and opened the way to sell another car to the jobber.[5]

Another example of the same nature is that of the Land O' Lakes Creameries Association, Inc. Their government-inspected butter is now shipped even as far as Central America, in special packages designed to protect the quality. "Eat-more-and-better-butter" campaigns have been carried out in order to show the food value of butter in general, and Land O' Lakes in particular.

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[5] Adapted from R. S. Vaile, *Economics of Advertising*, pp. 136–137.

Still other examples could be cited to show the campaigns carried on by some cooperative organizations to increase the use of their particular products. For instance, in 1927 the following sums were expended by cooperative organizations for magazine advertising: Sun Maid Raisin Growers, $491,-350; California Walnut Growers, $68,650; American Cranberry Exchange, $44,925; National Kraut Packers, $21,000.

The second type of developmental work, that of *educating the producers,* has been an important part of the program of nearly every cooperative organization. Better quality and fewer varieties make it easier for the cooperatives to carry out their functions. Many areas produce a great many varieties of a particular product; thus, in any neighborhood may be found brown eggs, white eggs, a mixture of the two, large eggs, small eggs, and so on. The task of marketing eggs cooperatively is facilitated greatly by standardizing the variety produced in any one area. This may also lead to improvements in the production methods and quality of the product. It is said that the developmental work of the Land O' Lakes organization has done much to improve the quality of the raw materials handled by the local member creameries.

Research work, which is beyond the scope of an individual producer, is frequently undertaken by cooperative organizations, particularly by the larger ones. This relates especially to the utilization of by-products and finding new uses for the main product. Thus, orange and lemon product plants have been developed by a cooperative organization to convert low-grade fruit into products such as citric acid, orange and lemon oil, marmalade, and so on. Such operations result both in better returns to the growers and in better average quality of fruit reaching the markets. It should also be pointed out, in passing, that a similarly effective handling of by-products has been accomplished in the wheat trade by millers, and in meat products by packers, rather than by cooperatives.

5. Stabilization of Price. Attempts to stabilize prices, either for short or for long periods, are beyond the scope of the small local cooperative organizations. The large cooperatives, however, can wield some influence over short-time prices by directing the flow of products as between markets, thus preventing gluts and scarcities, and thereby possibly getting a higher average return for all producers. Over long periods it is possible to attempt to forecast the proper acreage and, by propaganda, to influence producers to expand or contract production as market conditions make expedient. It is doubtful, however, if cooperatives can go very far in definitely controlling output so as to obtain monopoly gains. In the first place, agricultural production is uncertain because of the dependence upon climatic conditions. Secondly, even cooperatives are subject to anti-trust laws, if prices are "unduly enhanced."

Standardizing the commodity and the package, so that consumers may know all the facts about the product, may also lead to higher average returns.

Generally speaking, the gains which may be expected from cooperatives depend upon the present state of the marketing organization for the commodity in question, and also to a large extent upon the members themselves. Cooperation is not a cure-all for any and all ills of agriculture. To succeed there must be some understanding on the part of the members of the purposes and objects to be gained. Certain functions, as outlined in Chapter 3, must be performed in marketing every commodity. If a cooperative organization is to succeed it must perform those functions at least as well, or better, than they were formerly performed by private institutions. Certain middlemen operating in the market may be eliminated by a cooperative organization. The functions performed by those middlemen remain, however, and must be performed by some one.

Failures among Agricultural Distributive Cooperatives.—A summary of the causes of failure among farmers' cooperative organizations points out the importance of a statement made earlier in the chapter, namely, that cooperatives are merely one form of business organization, subject to the ills and misfortunes of business in general. The following table, compiled by the United States Department of Agriculture,[6] shows the reasons assigned for the failure of about 1,000 associations during the ten-year period, 1913–1923. Many organizations reported several reasons which operated jointly towards their failure.

Reasons for Failure	Number of Associations
Inefficient management	558
Lack of interest among members	556
Insufficient business	326
Insufficient working capital	282
Insufficient members	222
Too liberal credit	187
Inadequate accounting system	114
Lack of proper audit	103
Dishonest management	100
Capital stock in hands of too small a group	32
Property damaged by fire	12

Present Extent of Agricultural Cooperation in the United States.—It is estimated that the total membership of the 10,803 associations in the United States at the close of 1925 was 2,700,000. This figure is considerably larger than that representing the total number of farmers served by cooperatives, as many farmers belong to two associations, some to three, and a few to four. A recent survey gave 1,800,000 as the number of farmers served through cooperatives in 1925.

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[6] Fed. Trade Com., *Cooperative Marketing*, p. 302.

The table on page 354 gives the status of agricultural cooperatives in 1925, grouped by general location, by states and by commodities.

"More than one-half of the total cooperative membership in 1925 was in the associations in the 12 north central states. Slightly over 20% of the total membership was in the 8 south central states. The associations in the south Atlantic group, including Delaware and Florida, were credited with 10.4% of the membership, and the three Pacific coast states with 5.2%.

"In round figures, the 10,803 associations listed by the Department of Agriculture transacted business in 1925 to the amount of $2,400,000,000. By far the greater part of this amount represented sales of farm products. Perhaps one-tenth represented purchases of farm supplies. 70% of the total business was handled by the cooperatives in 15 states that make up the north central and the Pacific coast groups. The remaining 30% of the cooperative business was handled by the associations scattered through 33 states.

"The largest volume of business credited to any state was $223,980,000 for the 1,383 associations listed for Minnesota. California ranked second to Minnesota and had a total estimated business of $223,960,000 for the 350 associations. Illinois was third in importance, Iowa held fourth place, and Wisconsin and Ohio fifth and sixth places, respectively. New York and Kansas were seventh and eighth in importance. These eight states transacted 51% of the total cooperative business." [7]

The Agricultural Marketing Act of 1929.—The recent (1929) federal enactment creating a Federal Farm Board to help the farmers solve their problems may bring material changes in the status of agricultural cooperatives in this country.[8] The act aims, for one thing, to give the farmers collective

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[7] R. H. Elsworth, *op. cit.*, pp. 26–27.

[8] See Appendix D for a copy of the act.

Status of Agricultural Cooperatives in 1925

	No. of Assoc. Listed	Estimated Membership		
		No. of Members	%	Cumulative %
District Groups				
West North Central	4,825	850,000	31.5	31.5
East North Central	3,075	575,000	21.3	52.8
East South Central	277	295,000	10.9	63.7
South Atlantic	385	280,000	10.4	74.1
West South Central	454	250,000	9.2	83.3
Middle Atlantic	522	160,000	5.9	89.2
Pacific	643	140,000	5.2	94.4
New England	259	75,000	2.8	97.2
Mountain	363	75,000	2.8	100.0
Total	10,803	2,700,000	100.0	
State Groups				
Minnesota	1,383	217,400	8.1	8.1
Kentucky	56	194,700	7.2	15.3
Iowa	1,094	179,800	6.7	22.0
Missouri	537	170,600	6.3	28.3
North Carolina	50	139,900	5.2	33.5
Illinois	822	131,000	4.8	38.3
Michigan	436	128,300	4.7	43.0
Wisconsin	1,092	120,100	4.4	47.4
Ohio	395	115,300	4.3	51.7
New York	286	100,000	3.7	55.4
Oklahoma	143	92,200	3.4	58.8
California	350	91,200	3.4	62.2
All others	4,159	1,019,500	37.8	100.0
Total	10,803	2,700,000	100.0	
Commodity Groups				
Grain	3,338	520,000	19.3	19.3
Dairy products	2,197	460,000	17.0	36.3
Livestock	1,770	400,000	14.8	51.1
Cotton	121	300,000	11.1	62.2
Tobacco	24	300,000	11.1	73.3
Miscellaneous buying	1,217	247,000	9.1	82.4
Fruits and vegetables	1,237	180,000	6.7	89.1
Miscellaneous selling	698	173,000	6.4	95.5
Wool	91	50,000	1.9	97.4
Poultry products	71	50,000	1.9	99.3
Nuts	39	20,000	.7	100.0
Total	10,803	2,700,000	100.0	

bargaining power in selling their products. This is to be accomplished through encouraging and aiding the organizing of cooperative marketing associations. And, recognizing that each small local cooperative competes with all the others in the field, the plan calls for a super-cooperative for each farm product, a federation of all the scattered organizations into a single one for each commodity. Loans are to be made to farmers to aid them in the orderly marketing of their crop, but the loans must be made *through a cooperative organization.*

There is, therefore, a strong incentive for farmers to establish and join cooperative distributive organizations, and one would expect to see a material growth in membership during the next few years if the board's plans bear fruit.

One of the interesting early developments under the 1929 Act is in the wheat trade. The following chart shows the organization of wheat cooperatives, new and old, as they existed in February, 1930.

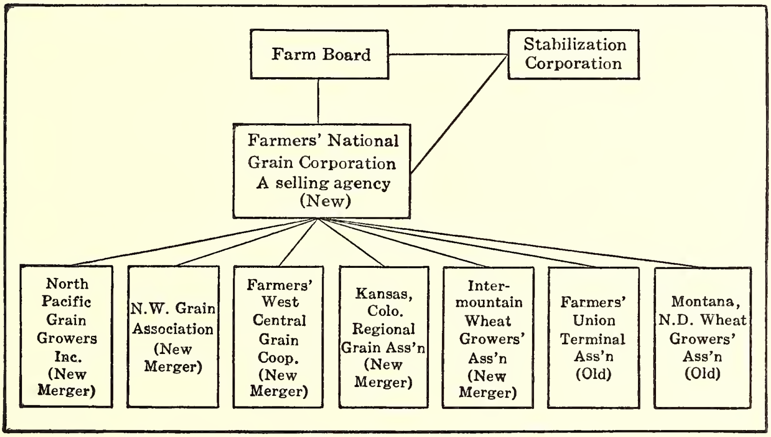
Farm Board
Stabilization Corporation
Farmers' National Grain Corporation A selling agency (New)
North Pacific Grain Growers Inc. (New Merger)
N.W. Grain Association (New Merger)
Farmers' West Central Grain Coop. (New Merger)
Kansas, Colo. Regional Grain Ass'n (New Merger)
Inter-mountain Wheat Growers' Ass'n (New Merger)
Farmers' Union Terminal Ass'n (Old)
Montana, N.D. Wheat Growers' Ass'n (Old)

Figure 24. Wheat Cooperatives Under Farm Marketing Act

As an example of the make-up of the new mergers, the Northwest Grain Association combines the following existing organizations: elevator associations in the four states of Montana, North and South Dakota, and Minnesota; Minnesota and South Dakota Wheat Pools; Farmers' Union of Aberdeen, S. D.; Farmers' Union of Devil's Lake, N. D. It should be added that this was a temporary alignment of grain cooperatives. By 1931, a considerable number of other organizations have become members of the Farmers National Grain Corporation.

The Farmers' National Grain Corporation is a central sales agency for the federated group of cooperative associations. As yet there is no standardization in the organization of the various affiliated units and, in fact, there appears to be some jealousy and lack of harmony among them. This is the temporary result of the attempt to amalgamate several existing organizations; these differences will likely be removed in time.

The Stabilization Corporation is organized to finance the buying and holding of grain during periods of "surplus." It will be successful just to the extent that it accurately forecasts periods of rising prices and holds grain for sale at those periods.

Many problems confront so large an industry as the wheat industry in its attempt to organize the individual producers for cooperative action. Competition with a thoroughly established trade is the first of these problems. If farmers are to be interested in cooperative marketing they must see some tangible gains and these will be difficult to make in a trade where the efficiency is already as high as in the grain trade.

Even if economies and direct benefits can be realized through cooperative selling, it will be necessary to work out in careful detail the exact membership affiliations, the desirable methods of paying the farmers for their grain, the method of "pooling" the grain to give each farmer his proper share of the proceeds without the expense of keeping individual lots separate, and many other problems. Member loyalty will be one of the most difficult things to maintain; in fact, no such huge membership as is contemplated under the Farmers' National Grain Corporation has yet been successfully held together under cooperative principles in the United States. With the strong backing of the federal government, the movement has every opportunity to succeed. Certainly it will be watched with great interest by all students of marketing.

The Canadian Wheat Pools.—In Canada a somewhat similar federation of cooperatives has been a strong factor in the sale of wheat since 1924. Organizations in the three provinces of Alberta, Manitoba, and Saskatchewan are affiliated in the Canadian Cooperative Wheat Producers, Ltd., which acts as a selling agent for the entire group of cooperatives. The organization within each of the provinces is similar, so description of one will serve for all.

For the organization purposes of the Alberta Wheat Pool the province is divided into seven main districts. Each of these districts is divided into ten sub-districts. Each sub-district is represented in the main districts by a delegate elected by the Pool members of that sub-district. Each main district is represented on the board of the Alberta Wheat Pool by a director who is chosen annually by the ten delegates from his district. These directors are the governing body of the Alberta Wheat Pool and they also elect the Alberta representatives on the board of directors of the central selling agency.

The Alberta Pool has nearly 300 locals. The principal purpose of these locals is to keep the members in communication with the central organization, to foster loyalty and understanding of the activities of the governing bodies. Any community may have a local and each farmer-member in the organization is a member of one of the locals.

The Alberta Pool Elevators, Ltd., is a subsidiary of the Alberta Wheat Pool. Its governing body is the board of directors of the Alberta Pool. This organization operates a line of country elevators at all important wheat-producing points in the province and large terminal elevators at Prince Rupert and Vancouver.

The Canadian Cooperative Wheat Producers, Ltd., has complete charge of selling all the grain of the three provincial pools. The latter take delivery of the grain from the farmers and turn it over to the central selling agency when it reaches the terminal markets. The selling agency sells the grain and, after deducting the actual costs of selling, remits the proceeds to the individual pools on the basis of the amount, kind and grade of grain delivered. The selling agency is governed by a board of nine directors, three from each province, who are elected from the provincial boards.

The extent to which the Canadian wheat pools have been successful in lowering costs of marketing or in obtaining higher prices for the farmers is still problematic. Because of the short period of operation and the controversial nature of the situation, it is impossible to get reliable data on the subject. Prices received by Canadian pool members appear to have been relatively good in recent years, but there is some reason to believe that a larger than usual carryover has been accumulated, which may serve to disrupt the market later.[9]

Those in charge of the development of cooperative marketing of wheat in this country will profit much by the Canadian experience and should be able to avoid some of the early mistakes.

American vs. European Development.—While the foregoing tables and notes on the development of agricultural distributive cooperatives show a significant development in North America, the movement does not as yet rival that in some European countries. It is said, for example, that in Denmark there are five times as many members of cooperatives as there are farmers, most farmers being members of several organizations.

This difference in development may be attributed to several causes. In the first place, the need for collective action has probably not been as imperative in America as it has in many European countries. For that reason, appeal here has often been to prejudice and emotions, rather than to intelligence. Secondly, the whole development of our country, with its frontier problems, has made for individualism. Finally, differences in race and religion, and the consciousness of kind have been a serious hindrance to cooperative activity in many cases in the United States.

The Public and Cooperative Marketing Organizations.—The public, through its various governmental agencies, is interested in cooperative marketing. This is evidenced by the numerous acts passed by Congress and by the various state legislatures, encouraging farmers to organize. Practically every state in the union now has on its statute books special laws providing for the organization of cooperative associations. The Capper-Volstead Act of 1922, exempting cooperatives from some of the provisions of the anti-trust laws, and the Act of 1929 which has just been discussed, are illustrative of the attitude of the federal government. Several years ago the Department of Agriculture established a Division of Cooperation to aid and foster the organization of cooperative associations for the marketing of farm products. Each of these recent movements has resulted directly from the post-war agricultural depression. To the extent, however, that they are really in the interest of efficiency in marketing they will doubtless retain governmental support. The principal problem in connection with cooperative enterprises is not likely to be any adverse attitude of government, but rather an unwillingness on the part of the farmers themselves to give up any considerable measure of their hard-bought individual independence.

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[9] Over-advances on the 1929 crop followed by almost continuous market decline brought about a financial crisis in the Pool affairs by early summer of 1931. The Grain Growers Cooperative Market organizations of the West provinces, associated in the Pool, have instituted reorganization proceedings preparatory to the movement of the 1931 crop.

CHAPTER 21

CONSUMER COOPERATION

Consumer Cooperation as a Means of Integration.—As pointed out in Chapter 19, integration is a prominent development in modern merchandising. Chain stores are an outstanding feature of this development, especially in the United States. In Europe, on the other hand, the forerunner and, in part, the counterpart of the chain store is *consumer cooperation*. As one feature of this movement many small retail units are affiliated under large wholesale societies which, in turn, may control many lines of manufacturing. Consumer cooperation plays an even more important rôle in retail distribution in many parts of Europe than chain stores do in the United States.

The two movements have different origins and implications, however. Consumer cooperation is an attempt on the part of the consumers to increase their real income and improve their scale of living by reducing merchandising costs and by making available just those things which the consumers desire. Chain stores, on the other hand, are organized by capitalists for profit; if they increase the real income of their patrons they do so incidentally.

Cooperation, wherever found, has usually originated because of inequality in bargaining power, and has succeeded wherever necessity for collective action was imperative. Farmers and consumers generally feel that they are at the mercy of the market operators, as concerns both price and kinds of goods to be obtained. A multiplicity of middlemen often stand between the producers and ultimate consumers, directing the flow of commodities to the various channels, and incidentally, adding their respective tolls to the cost of the product.

Aims of Consumer Cooperation.—One theory of consumer cooperation is, therefore, that goods may be obtained more cheaply, and more nearly in conformity with consumers' desires, by eliminating, in so far as possible, the various middlemen at present engaged in supplying the consumer market.[1] By so doing, many things are hoped for:

1. Lowering the cost of living, by eliminating some middlemen, and by taking over the functions of others and performing them more efficiently. The present marketing system is said to be expensive and wasteful. The gains made would, therefore, materially reduce the retail cost of goods.

2. Handling better goods, by dealing more directly with the producers and telling them what is wanted, rather than having dealers anticipate consumers' wants. The present economic order, with its highly competitive profit system, leads to unwarranted sales activity in pushing goods which yield the highest profits, regardless of the quality of the commodity.

3. Enabling consumers to learn more readily the truth about all commodities, and leaving them free to make their own choices. At the present time, fancy advertising and high-pressure salesmanship often deceive the consumers; the intense competition leads to adulteration and misbranding of goods and quite often to unduly high prices. Styles change so rapidly in some lines that the goods are obsolete before being barely used. If all consumers cooperated in buying, consumption would not be guided by the plans of the producers; quite the contrary, if carried far enough, producers would be told what to produce. Collective buying would mean sufficient bargaining power to dictate production policies, since every person is a consumer and hence eligible for membership in a consumer cooperative.

4. Educating consumers generally in the advantages of cash buying and thrift, inculcation of democratic business

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[1] The other theory of consumer cooperation, that of organizing a new political or social order based on consumer direction of production, is beyond the scope of this treatise.

methods, and the dissemination of useful information and cooperative propaganda.

The Limits of the Movement.—The extent to which these aims may be realized depends, of course, upon the magnitude of the movement. A small cooperative retail store can at the best accomplish only a small reduction in cost. On the other hand, if all, or most, stores were cooperatively owned, radical changes in the present distribution methods could be brought about, with possible far-reaching effects. Wholesale, and other central market agencies, could be taken over by a federation of the consumer cooperatives. Possibly this giant could reach out and take over all production, thus ushering in a new economic and social era. Or, it is conceivable that cooperative producers' organizations would successfully combat such a movement on the part of the consumers, so that the struggle would be between two giant organizations, one trying to exact the highest prices possible, and the other trying to reduce them. Neither of these complete developments seems possible at present, due to the fact that the diversity of ideas among producers and among consumers would prevent such effective cooperation.

The results achieved by one large consumers' cooperative in Great Britain, which will be discussed later, show the possibilities of this type of integration, and also the fact that complete control of production is not essential for the realization of the aims suggested above. Control of even a small part of the productive facilities—if successful—contributes enough of an entering wedge to prove the futility of any action against the consumers' movement, particularly if such action is not taken part in by all producers. Pressure on the part of a single producer would merely lead to the acquisition of more of the production facilities.

Operating Principles.—The success of consumer cooperatives, whatever the field of operation, depends also upon efficient operation and upon the adherence to certain fundamental cooperative principles. These principles, called the Rochdale principles, were formulated by 28 weavers in Rochdale, England, who, in 1844, laid the basis of the modern cooperative retail store on such a practical plan that consumer cooperative societies everywhere have followed their example.

The leading principles of the Rochdale pioneers are as follows:

1. Each member has only one vote at the general meetings, regardless of the number of shares of stock which he may own.

2. Only sound, unadulterated goods of full weight are sold.

3. Goods are sold at current market prices against cash payments.

4. The surplus, after payment of operating expenses, is distributed as follows: Part of it is divided among the members as patronage dividends, in proportion to their total purchases; part of it is used for educational and altruistic purposes; part is transferred to the reserve fund;[2] finally, a part is used in the expansion of the business, including the erection of warehouses, factories, and so on. The division between these different uses of the surplus is decided by vote of the members.

5. Shares are sold at a low price, usually about $5, and one share gives full membership privileges. In order that no one need stay out because of the cost of membership, provision is generally made that even this small amount may be paid in instalments, and partially out of earnings. Members may own more than one share, the upper limit being set by the rules of the particular society, but the rate of dividends which may be paid on these shares is generally limited to 5%. The shares are of two kinds, the membership shares which are transferable, and the investment shares which are withdrawable. Transferable shares can only be disposed of by transferring them to a person approved by the committee, whereas the others can

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[2] This part of the surplus is really better considered part of the operating expense, for its purpose is to convert an uncertain amount due to risk into a definite cost, as pointed out in Chapter 12.

be disposed of at will. Most societies make all but the first share held by a member withdrawable. So it comes about that members use their societies practically as savings banks by investing in shares when they have money to spare and withdrawing them when they need money.

The above principles have generally been adopted by every successful cooperative consumers' society throughout the world. Certain modifications are, of course, found, in order to conform to the laws governing cooperative societies in the various countries and states. But in the main, the Rochdale principles stand.

History of Consumer Cooperatives.—In 1844, the above-mentioned Rochdale weavers, then out on strike, came together for the purpose of discussing ways and means of improving their financial condition. The result of numerous conferences was that a cooperative retail store was started, with a capital of £28 ($135), one pound per member. Each of the members took turns as salesmen during the evenings, which was the only time the store was kept open during the first month.

The venture proved successful from the start; within a year the organization numbered 74 members, and in ten years had increased to 900 members. Other consumers noted the success of the Rochdale weavers, and soon the movement spread throughout the whole of Great Britain and the Continent.

The Cooperative Wholesale Society.—"Soon after the retail cooperative movement began to expand, the need was felt of a wholesale society which would give to the retail stores a stronger position as buyers. After several unsuccessful attempts there was established in 1867 the Cooperative Wholesale Society, generally known as the C. W. S. Most of the retail societies in England are members of the C. W. S. It is the crowning point of the cooperative distributive movement on its commercial side.

"The members of the C. W. S. are shareholding retail societies. Its directors are elected by the members en bloc, generally from among members whose ability has brought them to the front in their local society.

"The activities of the C. W. S. extend along four different lines, viz., (1) wholesale merchandising, (2) wholesale production, (3) banking and insurance, and (4) operation of plantations.

"The C. W. S. is first of all a wholesale merchant, and styles itself the largest democratic trading institution in the world. Its head office is at Manchester with branches in London and Newcastle and depots at Bristol, Cardiff, and other cooperative centers. For the year 1923 the wholesale distributive trade of the C. W. S. amounted to $320,000,000.

"The C. W. S. is the largest distributor of tea in the world and operates a large plant in London for blending, packing, and shipping tea, in which 454 men and women are employed. Its tea trade averages 60,000,000 pounds a year. Considerable quantities are exported to cooperative societies on the Continent.

"Another line of business which is growing rapidly is the cooperative sale of coal. The C. W. S. has divided its coal business into three districts, centering, respectively, in Manchester, Newcastle, and London and each is directed by a district manager. Sales are made only to registered retail cooperative societies.

"Secondly, the C. W. S. is a wholesale producer, industrial and agricultural. Most of the goods distributed by it through its wholesale department are produced in its own manufacturing plants, which in 1921 had an output value of nearly $100,000,000. These productive works include plants for the manufacture of (1) foodstuffs and kindred commodities, (2) textiles, clothing, underwear, and footwear, (3) furniture, utensils, and household requisites, and (4) diverse productive establishment such as printing plants, oil and sawmills, pottery and glass bottle works, motor vehicle works, and a coal mine.

"Thirdly, the C. W. S. operates a bank of its own at Manchester with over 1,500 agencies throughout the country. This bank conducts the accounts of over 1,000 cooperative societies in England and Wales, whose deposits range from a few thousand to over $5,000,000 per annum. In 1910, the bank adopted a scheme of individual deposit accounts which now exceed 20,000 with aggregate balances of more than $15,000,000. In 1922, the bank's turnover (deposits and withdrawals) amounted to $2,400,000,000.

"Fourthly, the C. W. S. is a large land owner. Its farms and estates in Great Britain comprise 33,552 acres with a nominal original value of $5,000,000. The C. W. S. also owns, jointly with the Scottish Cooperative Wholesale Society, tea plantations in the East aggregating 5,699 acres in Ceylon and 28,617 acres in India, and 10,000 acres of wheat land in Canada.

St. Cuthbert's Cooperative Association (Ltd.) of Edinburgh, a Retail Society.—"Among the member societies of the S. C. W. S., the St. Cuthbert's Cooperative Association (Ltd.) of Edinburgh, stands out as the leading retail cooperative society in Scotland. It was established in 1859, and in 1923 had approximately 62,000 members, being the only cooperative consumers' society in Edinburgh. Its members, while largely belonging to the working class, include people from all classes of society.

"For the year ending March 1923, the sales of St. Cuthbert's amounted to $9,000,000, and the patronage dividend rate was 16% of sales. It has special departments for bread and baking, draperies, tailoring, furniture, jewelry, shoes, tea rooms, crockery and hardware, laundry, drugs, meat, fish, groceries and coal, and it operates five farms. Its coal department supplies 75% of the city's coal trade, the sales for 1922 amounting to 130,000 tons. It has seven coal yards in different parts of the city and owns 260 railroad coal cars hauling coal from the mines to its yards.

"Due to its excellent system of business management, the distributive expenses of St. Cuthbert's have been kept down to a low level, amounting in 1923 to a total of approximately 10% of sales. All its employees are required to be members of a trade-union. It has been the policy of the society since its origin to put 2½% of the net profit into a reserve fund. As a result of this policy the actual reserve fund from that source now amounts to $1,500,000, so that for every member there is an actual reserve of over $25, and for every share of capital stock owned by members there is 30% in the reserve fund. For the encouragement of thrift the society has established a penny savings bank which for the first half-year of 1923 had a balance of over $350,000. For the benefit of its members St. Cuthbert's is affiliated with the Scottish Cooperative Convalescent Homes Association (Ltd.)."

The Cooperative Union.—"Practically all of the cooperative societies, both wholesale and retail, in the United Kingdom are federated into the Cooperative Union (Ltd.), which is a central organization for propaganda, legal assistance, cooperative education and defense, with headquarters at Holyoak House, Manchester.

"The present gigantic extent of the consumer cooperative movement in the United Kingdom may be seen from data covering 1922. In that year there were affiliated with the Cooperative Union 1,445 cooperative societies and associations with a total membership of 4,569,089 with $550,000,000 in share and loan capital and $50,000,000 in reserve funds. The employees numbered 183,195. The total trade of the affiliated retail societies in 1922 amounted to $800,000,000, and the net surplus to $60,000,000.[3]

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[3] In 1927 there were 5,535,000 members in the affiliated societies and the total sales were $975,000,000. Stat. Abs. for United Kingdom, 1929.

"Of the total number of societies and associations holding membership in the Cooperative Union, 1,321 are local retail distributive societies, which form the backbone of the whole movement. In the northwestern sections of England and in Scotland there are also 6 distributive federations embracing 64 societies which perform the functions of purchasing goods wholesale and distributing them to their federated societies. The membership of the union includes 105 productive societies, with 38,138 members. Some of these societies are primarily associations of consumers, others are composed of associations of workers.

"There are 4 supply associations with 8,542 members, 6 special societies aggregating 1,034 members, and lastly 3 wholesale societies, English, Scottish and Irish, with 2,162 member societies." [4]

Cooperation in Europe.—A study of consumer cooperation in other European countries reveals the same general development as that in Great Britain, except on a smaller scale. The extent of the movement in a few representative countries is illustrated by the following table:

NUMBERS OF MEMBER SOCIETIES AND INDIVIDUAL MEMBERS AFFILIATED IN THE CENTRAL UNIONS OF CONSUMER COOPERATIVES IN VARIOUS EUROPEAN COUNTRIES[5]

	Members	Societies
Germany	3,161,000	1,350
France	2,500,000	4,790
Scandinavia	700,000	3,000
Switzerland	370,000	505
Finland	170,000	470
Poland	360,000	550
Belgium	230,000	150

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[4] Report of Federal Trade Commission, "Cooperation in Foreign Countries," 1925, pp. 3–6.

[5] This list is not complete for there are consumer societies in practically every country in the world.

International Cooperation.—The consumer cooperative movement in Europe long ago transcended national boundaries, so that today about 30,000,000 people, all affiliated with cooperative societies, are joined in the International Cooperative Alliance. This organization, which represents the central agency of the cooperative movement in the world, was organized in 1895 for the promotion of cooperative principles and practice on an international scale. Headquarters are in London. The Alliance publishes a monthly bulletin printed in English, French, and German.

Consumer Cooperation in the United States.—The consumer cooperative movement has never gained any great headway in this country. While cooperative retail stores were found as early as 1845,[6] at no time has the movement become important enough to be of any special significance as a factor in marketing. Cooperation in retailing has developed, but its impetus has come from merchants rather than from the consumers. Regular chains integrate operations much as do the consumer societies, while the voluntary chains involve also the *spirit* of cooperation among the individual proprietors. Economic necessity is back of each movement, although the resulting organizations are somewhat different in the two cases.

Consumer societies are found, however, in practically every state in the Union. There are numerous farmers' organizations distributing feed, fuel, twine, etc., for their members. Cooperative retail stores are found in New York, Illinois, Minnesota, Wisconsin, Washington, and other states. In Minnesota alone there were reported 189 cooperative stores in 1922. In Superior, Wisconsin, the Central Cooperative Exchange does the wholesaling for about 100 cooperative stores in the surrounding territory. This organization did a business of over $600,000 in 1924. Farmers' cooperative gasoline stations are found in many states.

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[6] The Workingmen's Protective Union store in Boston dates back to 1845.

In 1916 the Cooperative League of America was started in New York City, to serve as a "national association for cooperative unity and education." This organization, made up largely of consumer cooperative societies, acts as a clearing house for cooperative information. It publishes literature on cooperation and sends out lecturers and advisers to preach the cooperative gospel.

Many other cases could be cited to show that consumer cooperation has at least obtained a foothold in the United States.[7] Several factors, however, account for the relatively slow development. In the first place, the mixture of races, with resultant variations in habits, religion, and customs, is not conducive to widespread cooperation. Secondly, the economic necessity to bring about a new distributive mechanism has been largely absent. While there undoubtedly is much poverty in many places, the population as a whole is enjoying a fairly high standard, and therefore does not generally feel impelled to seek the gains which might come through cooperation. Thirdly, the cooperative retail movement has never become strong enough in most places to get away from the animosity of wholesalers and manufacturers, who see in the movement a menace to their own prosperity. There has often been much discrimination against cooperative stores, wholesalers in many cases even refusing to sell to them. Finally, there have been started many spurious "cooperatives" and many fanciful schemes for reaching the poor man's utopia, which have resulted in discrediting and retarding the movement in many areas.

While there undoubtedly are many cases of successful consumers' cooperatives in this country, the movement does not promise to become of importance in marketing for some time to come.

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[7] See "The Cooperative Consumers' Movement in the United States," published by the Cooperative League of America, New York, 1926.

Some Comparisons Between Agricultural and Consumer Cooperation.—Because of the difference in the success of the two cooperative movements which have been described in this and the preceding chapter, it is of interest to compare and contrast their outstanding characteristics.

The ideas and principles common to both are:

1. One man—one vote.
2. Limited dividends on the investment in the enterprise.
3. Distribution of any surplus funds in proportion to the use made of the organization.
4. Emphasis on standardized products.
5. Members are granted the privilege of withdrawal under certain stipulated conditions.
6. One primary purpose of each type of organization is to give to small operators the benefit of concentrated power. This power is directed toward buying in the one case (consumer societies), and toward selling in the other (agricultural associations). Many of the contrasts between the two classes of cooperatives arise from this difference in the direction of activities.

The agricultural distributive associations started later and have, therefore, borrowed their form of organization and many of their principles of operation from the consumer societies. The principal contrasts are as follows:

1. The consumer organizations are interested in lower prices in the retail market, while the agricultural cooperatives are interested in higher prices in the producer's market. Both of these ends might be accomplished simultaneously by reducing the spread between prices in the two markets. While marketing costs and margins are undoubtedly reduced by each organization, it does not follow that either group would be satisfied with a division of the savings. Certainly the consumer societies in Great Britain and Continental Europe hold the agricultural

cooperatives in little better regard than they do any other profit-seeking producers.

2. A further distinction of the same general sort is that the consumer societies desire to *save* money, while the agricultural associations attempt to *make* money. The sellers work to expand demand, i.e., to increase the price which will be paid for a definite quantity of product, while the buyers are interested in finding larger sources of supply at the same, or at a reduced price.

3. Agricultural cooperatives have, in the main, adopted all the methods and philosophies of corporate producers. They represent a conservative movement toward producer or capitalistic control of social institutions. Their activities have been directed toward convincing consumers that the goods offered by the cooperatives are the "best" on which to expend income. They are in direct competition with corporate and individual sales organizations which use identical sales methods and which pass the profit, if any, to producers.

Consumer cooperation, on the other hand, has been described as an "anti-capitalistic, revolutionary movement, aiming toward a radical social reconstruction."[8] The consumer cooperative believes that *demand* rather than *cost of production* creates value, and that, therefore, production should be molded to coincide with consumers' desires, rather than that desires should be molded to production plans. And the consumer cooperative further believes that there will be the closest agreement between production and consumption, with a resulting minimum of waste, when there is an association of consumers to act as a clearing house for recording and giving voice to consumer demands, and when these desires are reported directly to the manufacturer through consumer-controlled outlets.

Consumer Cooperation Not Socialism.—It should be pointed out, however, that consumer cooperation, although anti-capitalistic, is not socialism. It differs from socialism in that it recognizes no class struggle or division of society into classes. We are all consumers and as such we may all take part in this movement, sharing in the net gains of industry in proportion to our contribution made through consuming the products of industry.

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[8] A. Sonnichsen, *Consumer Cooperation.*

CHAPTER 22

TRADE ASSOCIATIONS

Trade Association as a Form of Cooperation.—Two forms of cooperation already have been discussed. In Chapter 20, dealing with agricultural distributive cooperation, it was pointed out that producers of farm products often combine, and set up certain organizations to market their commodities. By so doing they hope to make certain gains, due to enhanced bargaining power and better methods.

Cooperation among consumers was discussed in Chapter 21. By such combinations, the members hope to enhance their bargaining power as consumers, and to get more voice in the distribution of goods. It was also pointed out that both consumers' and producers' organizations usually grow out of some definite need for action, and that they commonly flourish during depressions.

The present chapter deals with a third form of cooperation, that among producers of other than agricultural products, and among dealers. This form of collectivism has become increasingly important in recent years, both as a factor in production and in marketing. In this country, as well as elsewhere, it is becoming increasingly evident that unmitigated competition is no longer to be looked upon as the ideal situation in business. Intense competition often leads to combinations of various types and may eventually lead to destruction of many units in an industry and, hence, finally to detrimental monopolies. Regulated competition, on the other hand, such as that permitted by our government to some forms of cooperative enterprise, appears to be a solution for both evils—cut-throat competition and monopoly. Trade associations provide such cooperation and also the medium for the working out of many business problems; they have, therefore, been gaining in favor during the past two decades.

Only the nature and activities of this form of cooperation will be discussed here. The organization structure and most of the legal problems involved are beyond the scope of this treatise, except in so far as they lead to any modification of the performance of the marketing functions.

Nature of Trade Associations.—"A trade association is an organization of producers or distributors of a commodity or service upon a mutual basis for the purpose of promoting the business of their branch of industry and improving their service to the public through the compilation and distribution of information, the establishment of trade standards, and the cooperative handling of problems common to the production or distribution of the commodity or service with which they are concerned." [1]

It will be noticed that a trade association is a form of cooperative organization. That does not imply the consolidation of all units of an industry under one management; each firm remains free to determine its own policies. Further, a trade association must not be confused with commercial organizations, such as civic and commerce associations or chambers of commerce. The latter usually include all firms within a certain jurisdiction, without regard to the nature of their business.

It should be emphasized that a trade association is usually limited to members of a certain industry or trade, or to closely related industries, regardless of their location. Often there is a retailers', a wholesalers', and a manufacturers' trade association for a given product; and an association may be formed to include all the concerns which handle that particular product. A single firm may thus be a member of more than one association.

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[1] See *Handbook,* American Trade Association Executives, Chicago, 1924.

These organizations, then, represent cooperation in business; they are designed to benefit the individuals of the industry which they represent. The benefits actually obtained depend, of course, to a large extent upon the type and size of the organization. Effective cooperation may lead to monopoly control of an industry and consequent illegitimate gains. On the other hand, as will be pointed out later, it may mean more efficient, and hence cheaper, operation.

Types of Trade Associations.—Because of the large number of trade associations now in existence, and their wide diversity as to organization and practices, definite classification is not possible. One may, however, distinguish between major types on the basis of (1) scope of operation, and (2) geographical extent.

1. Very few trade associations take in the entire field of an industry; such an organization would be too unwieldy, particularly when there are many steps involved in the processing and marketing of the commodity.

A separation may be made first as between manufacturers' and traders' service organizations. For example, manufacturers, wholesalers, and retailers of a particular commodity may each set up a trade association to deal with problems peculiar to their business interests. For example, there is a Hardware Manufacturers' Institute which is primarily a manufacturers' organization; there is also a National Association of Hardware Wholesalers, and a National Retail Hardware Association.

There is also quite often a further separation within a single industry, each association limiting its work to a specific branch. For example, in the lumber manufacturing industry is found the Hardwood Manufacturers' Association, the Plywood Manufacturers' Association, and the Mahogany Association. There are, however, some organizations which include all the processes of the industry in their activities, such as the

Petroleum Institute and the American Feed Manufacturers' Association.

By having each phase of the industry and each step in the production process separately organized, each association can take care of its own particular problems more efficiently. A smaller group can always work more harmoniously than a larger one; willingness to cooperate is more easily secured.

2. While a trade association is usually national in scope, in many trades the really active divisions are local or sectional. Many national associations undoubtedly got their start in the same way as some of the large agricultural cooperative enterprises. That is, they represent a federation of previously established local organizations.

In most cases, a local organization is not adequate to undertake the numerous activities commonly attributed to trade associations. In some fields, however, where competition is not on a national scale, only local or sectional units are feasible, with perhaps a central organization to act as the clearing house for information. For example, organizations of cleaners and dyers must necessarily have local autonomy, since each city would present special problems. Examples of local organizations are the Pennsylvania, New Jersey, and Delaware Wholesale Grocers' Association, the Danbury-Bethel Fur Hat Association which represents a group of cities, and the Northwest Retail Hardware Association.

In most cases, however, trade associations are national in scope. Even the so-called local organizations are ordinarily members of a national federation. Examples of national associations are the National Macaroni Manufacturers' Association, the National Retail Hardware Association, and so on.

It should, perhaps, also be pointed out that trade association activities even transcend national boundaries. International cooperation in business has been one phase of post-war European recovery. On this side of the Atlantic, some cooperation between tradesmen in the United States and Canada is found. Examples are the International Electrotypers of America and the International Baby Chick Association.

Thus, a trade association may be local, representing a certain industry within a city, state, or section, or it may be national and international in scope. Since the most common type is the national association, any reference here will be understood to imply that form.

To summarize:

"Trade associations represent a natural development of our commercial and economic life. Their extraordinary network extends through practically all branches of industry and trade. Most associations are national in scope; a few are international. There is no common pattern for their organization. Some are constituted horizontally, comprising certain stages of production or distribution; others are constituted vertically, their membership including representatives from every link in the chain, from producer of raw materials to the ultimate retail distributor. Organizations of a technical nature resembling trade associations in many respects, and closely affiliated with them, introduce tangents and diagonals into the business organization charts. Certain firms may belong to as many as a dozen associations. A manufacturer of chemicals is probably interested in not less than five associations of manufacturers alone. The same is true of a manufacturer of hardware. Variety of function and geographical distribution of the membership may create diversity where uniformity seems desirable.

"Sometimes there are two or more associations supplying identical services divided because of some original difference of opinion or other peculiarity. Undoubtedly, there is duplication of effort and overorganization in some portions of the field." [2]

Development of Trade Associations.—Trade associations are by no means a new thing in business. The Bible has allusions to organizations of goldsmiths and other enterprises. The history of Rome and of early England shows organizations of traders and of producers.

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[2] U. S. Dept. of Commerce, *Trade Association Activities*, 1927, p. 1.

In this country, trade associations can be said to date back to the Civil War period. The United States Brewers' Association was organized in 1862; the Carriage Builders' National Association was started in 1872; other organizations, many of which are still in existence, started during that early period.

Trade associations did not, however, play any important rôle until after the turning of the century. The real impetus to trade association development came during the late World War. It was early recognized then that federal authority could not cope alone with the problem of effective mobilization of the nation's resources. The most obvious means of meeting the emergency was, therefore, to deal through trade associations.

The advantages of business cooperation thus having been demonstrated during the war, the post-war period saw a fairly rapid development of trade associations, together with a better understanding of the legitimate benefits to be derived through cooperation.

It has been held by many writers that trade associations, like agricultural and consumers' cooperatives, are "children of necessity," and that, therefore, their greatest development and activity comes during a period of business depression. A study of the dates of organization of representative associations, however, would tend to show the opposite to be equally correct. In other words, trade associations are more in the nature of offensive than of defensive weapons.[3]

Activities of Trade Associations.—As was pointed out above, a trade association is organized for the purpose of bringing gains to the individual members. To a certain extent,

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[3] See National Industrial Conference Board, *Trade Associations: Their Economic Significance and Legal Status,* Ch. I. See also J. H. Foth, *Trade Associations,* Ch. I.

"unhealthy" competition is abolished, in favor of constructive cooperation. That does not necessarily mean that they exercise bad monopoly practices, although in many cases this may be true. Rather, it means a recognition of the complete interdependence of the various business units in present economic society, and also of the fact that every business failure usually reacts unfavorably on the whole industry. It becomes, therefore, the function of trade associations to aid the individual members in such a way that *all* may stand together, rather than fall separately.

In order to accomplish this aim, trade associations must perform two general types of activities:

1. *Commercial* activities, which are its activities in connection with buying, selling, credits, collections, and so on.
2. *Industrial* activities, which are its technical activities in connection with economy of production, information relative to production, standardization of various kinds, and other incidental functions.[4]

Commercial Activities.—

1. PURCHASING. It is important for a manufacturer or a trader to know where and when prices are the lowest. For any one firm, however, such information is often difficult and costly to obtain. One important activity of a trade association becomes, therefore, the collection and dissemination of information regarding the purchasing of raw materials and supplies. Members, by exchanging such information, are in a better position to judge supply sources, and there is less danger of destructive price cutting being inaugurated. Each buyer is still free to buy where he pleases.

Further, joint buying often is cheaper than individual buying. Farmers and consumers have long practised such cooperation. Recently, retailers have undertaken group buying, often on a large scale. Manufacturers, through a trade association, can often pool purchases and thereby insure minimum prices. For example, in place of numerous retailers bargaining independently with one wholesaler, a single buying organization bargains for all. Thus, bargaining power may in many cases be more equalized.

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[4] See E. H. Naylor, *Trade Associations*, p. 97.

2. Selling. It is in connection with selling that trade associations have had their greatest legal difficulties. There is obviously a temptation for a strong association to attempt to dictate prices, and to encourage joint action to charge higher prices. Many important selling services may be legally performed by the trade association, however.

First, it can prevent destructive and wasteful competition. This is made possible by gathering and making known to members the methods whereby competitors keep costs down, and by setting up certain standards of performance.

Second, the association can carry on advertising for the trade. This is of particular importance when there are numerous small firms in an industry and when there is a national market. It may suppress undesirable advertising, and counteract propaganda put forth by sellers of substitute products.

Third, the association can regulate the current abuse of cancellation of orders. Many manufacturers and retailers may order goods for delivery at a later date, only to cancel the order if prices have dropped in the meantime. Many associations have done much to reduce this waste, by investigating the cases and enforcing the rights of members where possible.

Fourth, many associations have done much to solve the problem of differentiation between manufacturers, jobbers, and retailers as to functions. This problem has been especially important since the coming of large chain store organizations. If manufacturers sell direct to some retailers, at jobbers' prices, the jobber is obviously placed at a big disadvantage. A trade association can do much to work out the best solution for such problems.

3. Commercial Research. A third important activity of trade associations is the compilation and dissemination of statistics concerning its field. A "perfect market" is found only when all dealers have complete information about supply and demand conditions. Data on crops and other raw materials, supply sources, new markets, and new uses for the products may be collected by an association.

Some of the commercial research is at present carried on by universities and colleges, with the active support of trade associations. For example, the National Retail Dry Goods Association supports the Prince School of Education for Store Service. Some of the investigations of this latter organization include methods of operating bargain basements, personal shopping service, merchandise control of stocks, and so on.[5]

4. Cost Analysis. As a means of increasing efficiency and of avoiding cut-throat competition due to wide differences in cost, some associations have devised and encouraged the adoption of standard cost accounting systems in the individual firms.[6] By collecting the various cost figures a "standard" may be set up as a test of efficiency.

5. Interchange of Credit Information. A valuable service rendered to members is the collection of credit data. The information gathered usually concerns a creditor's purchases, promptness of payment, business capacity, and character. Many associations regard this activity as their most important function.

6. Improvement of Marketing Methods and Business Practices. Much has been done by trade associations to develop a code of ethics and a "standard practice" regulation for business firms. Among other things, this involves the recognition of business courtesies and the respecting of the

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[5] See U. S. Dept. of Commerce, *op. cit.*, p. 72.

[6] See *Cost Manual* of the Wool Institute, Inc., September, 1928. It is stated in the manual that it "will enable the Woolen and Worsted Cloth Weavers of the United States to know and record their ability to produce these essential fabrics in comparison with all other manufacturers of the same cloths, as well as to keep accurate comparisons with the best that they have ever done in the past themselves."

privileges of competitors. Breaking contracts, bribing the competitor's employees, and publishing unfair statements about rivals are some of the evils which are remedied. A typical code of ethics for a trade association is given in Appendix E.

7. Establishment of Traffic Bureaus. This involves chiefly the question of rates, freight classification, minimum carload weights, and so on. As pointed out in Chapter 15, any changes in freight rates may upset the existing relationship between industries and areas. The trade association is interested in keeping the industry which it represents from bearing an undue burden of traffic charges.[7]

8. Commercial Arbitration. Trade association activity in respect to this matter arises chiefly in the case of organizations made up of industries engaged in successive processes. For example, the National Boot and Shoe Manufacturers' Association, the National Association of Shoe Wholesalers, the National Shoe Retailers' Association, and the Tanners' Council of America have set up a council of arbitration to settle any controversy arising between members of these several organizations.

Industrial Activities.—

1. Information Regarding Raw Materials. This involves a study of sources and quality of the available supply, since many small firms are not in a position to analyze and test the quality of the products which may be used in their particular business. For example, the scientific bureau of the National Association of Paint Manufacturers has been studying the best methods of flax production, and has been testing the value of substitute products.

2. Standardization and Simplification. As pointed out in Chapter 23, standardization and simplification are important adjuncts of marketing. A comparison of quality of

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[7] See Report of the Traffic Department of the National Association of Farm Equipment Manufacturers, 1923, pp. 110–116.

various materials is impossible unless definite and definable standards have been set up, and unless some agency, governmental or private, can supervise the grading. While the government has set up standards and testing services for many agricultural products, no similar service for many raw materials of industry has been available, until inaugurated by some trade association.

3. Elimination of Waste in Manufacturing. This involves primarily the study of utilization of waste materials and by-products. Many trade associations have established laboratories and experimental departments for the scientific investigation of such problems.

Other industrial activities are the interchange of patent rights or the pooling of patents, and the conservation of raw materials, such as oil and timber.

Incidental Activities.—Among other activities undertaken by trade associations may be mentioned labor adjustments, and legislative activities—"lobbies." Many associations maintain a lobby in Washington, D. C., to look after legislative matters concerning their interests. All matters of tariff schedules and other acts affecting the welfare of groups of manufacturers are studied by such a lobby.

Trade Associations and Prices.—The greatest difficulties which trade associations have had to overcome in justifying their existence have resulted from the question as to their effect on consumers' prices. In order to advise members in all matters pertaining to the welfare of their particular industry, it is inevitable that an exchange of cost and price information will take place. Since all costs and prices are thus known to every member, one would suppose that a division of the market and uniform—perhaps monopoly—prices would result. Granted, it may be argued, that cut-throat competition, with its accompanying business failures, is a bad thing for society, are monopolistic prices any better? Further, it may be argued that too much cooperation within each industry may build up organizations capable of preventing competitors from entering the field. The members of the associations may agree to divide up the trade territory, or agree to fix prices in each market area, so that practically a monopoly condition would exist. All producers could then control price and competition by creating a common marketing organization for the group, eliminating competition both in buying and selling. Agreements to refrain from competition in service could also be resorted to. Hence, it may be argued, trade associations have the opportunity to take advantage of consumers in many different ways.

Checks to Unfair Practices.—The answer to the above arguments is that while unfair business tactics often are made possible by organizing a trade association, and while some associations have—and do—take advantage of their situation, nevertheless, it is improbable that much harm can result. Two checks protect the consumer against unfair practices, namely, competition and governmental regulation.

COMPETITION. Competition does not always guard the consumer. When a majority of the business units in an industry are small, however, it is usually difficult to bring all operators into a single organization. Lumber dealers in one city may form a trade association and agree to refrain from competing; but all lumber dealers in a nearby city may not want to join the association. Or, if the majority of the members of an organization agree to curtail production or to raise prices, the minority may immediately and unanimously agree to do exactly the opposite. It is doubtful, therefore, if associations made up of many small operators can succeed in unduly hindering free competition, and in establishing unfair prices. Further, while "fair" prices may not result from monopolistic agreements, neither do they always result from blind, destructive competition. A trade association aids in regulating and stabilizing the industry, through research and cost analysis; by these means fair prices may be realized.

Governmental Regulation. The other check to unfair practices is governmental supervision of business activities. Such supervision is based upon the theory that organized industry and trade, if a laissez faire policy is maintained, may resort to tactics which are inimical to the welfare of society in general.

In following out this theory, the government has put upon its statute books certain acts which are designed to prevent unreasonable restraints of trade and to insure fair competition in business activities. The acts referred to are the Sherman Anti-Trust Act of 1890, the Clayton Act of 1914, and the Federal Trade Commission Act of 1916, all of which are more fully discussed in the next chapter.

Regulation of trade is not a new thing. Not so many centuries ago the idea was held that the right to trade was a sovereign right which might be granted to any person or might be reserved for the state. Gradually, a conflicting idea, that of individual freedom of trade, came to be widely held, and laws were modified accordingly. Before the end of the last century, the formation of many large business organizations, and the methods which they pursued, led to investigations of trade practices. The result was the passage of the Sherman Anti-Trust Act in 1890. This act declared illegal any attempt to monopolize and restrain trade. It made a distinction, however, between any interference of individual freedom to trade caused by an individual and that caused by two or more individuals. It was recognized that restraint of trade was most likely to arise when a number of individuals combine; any interference with conditions of supply and demand when caused by two or more individuals or corporations working together was, therefore, prohibited.

Some of the things which, under the Sherman Law an association *may not do,* are as follows:[8]

1. Association members may not agree among themselves, either orally or in writing, directly or indirectly, to have a common, fixed, unalterable price.
2. Association members may not agree to limit their output or allot territory in which to confine their sales, or distribute business.

Some of the things which under the Sherman Law an association *may do* are as follows:

1. Its members may agree upon, adopt, and use trade customs relating to weights, qualities, standards, and so on.
2. It may gather, compile, and disseminate statistics as to trade, and the supply and cost of raw materials, including total amounts sold and prices at which sold.
3. It may investigate and adjust unfair business methods of wholesalers, jobbers, or customers, as the case may be, and may adopt a uniform cost system.

The Clayton Act, and other subsequent acts passed, only make more clear and definite the provisions outlined in the Sherman Act.

The whole question of legality of trade association activities is a matter which cannot be adequately covered in a short treatise. Much doubt exists as to the proper interpretation of various sections of the anti-trust acts. There are clearly certain illegal, and certain legal practices; but there are others, the exact status of which appears to be indefinite—to be in a "twilight zone."

Trade Associations and Marketing.—As pointed out in Chapter 13, marketing is inefficient unless it is based upon a sufficient analysis of the factors which make up the marketing process. To the extent that trade associations are engaged in the legitimate activities of collecting and exchanging market information, a better knowledge of the marketing processes and market channels results. In that respect, their work is somewhat similar to that of certain agricultural cooperative organizations, such as the California Fruit Growers' Exchange.

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[8] See E. H. Naylor, *Trade Associations,* pp. 307–308, and J. H. Foth, *op. cit.,* Ch. 16.

Extent of Trade Associations in the United States.—The 1929 directory of "Commercial and Industrial Organizations of the United States" issued by the Department of Commerce affords some basis for estimating the extent of the movement. The directory lists about 2,000 interstate, national, and international organizations. Many of these are at present inactive or not, strictly speaking, trade associations. It appears that only about 800 to 900 of these organizations could properly be called trade associations.

The directory includes also 2,000 state organizations, and 9,100 local organizations. A majority of these are only local chambers of commerce or fraternal organizations, however.

Trade Associations in Europe.—In view of the significant differences in method of operation, and in legal status of some European and American associations, a short summary of the former is interesting.

Combinations in some European countries are not of recent origin. A special type of trade association, the Kartell, was found in Germany toward the end of the last century. For example, the famous coal Kartell in western Germany was started in 1893. This is a cooperative association of mine owners, organized for the purpose of establishing monopolistic control of the market. The methods of operation of this association are as follows:

1. A central selling bureau, with offices in Essen, handles all sales. The bureau takes over all coal mined by the members, at a "take-over" price. If the coal is sold by the bureau at a higher price, the difference, less operating expenses, is prorated back to the producers. All orders for coal go to the bureau, not to the individual members.

2. Each mine is given a definite production quota for the year. If any mine produces more than its quota, it has to pay a fine per ton for the excess. If it produces less than its quota, it gets a bonus per ton. Thus production is controlled quite effectively.

3. The bureau has divided the market territory into a noncompetitive, a competitive, and a foreign area. The price charged depends upon the place where the product is sold.

This coal Kartell has been successful so far. The coal handled has been of fairly uniform quality, so that the selling problem and the division of the proceeds have not been difficult. The steel Kartell, on the other hand, has not been quite so successful, due to the multiplicity of products handled.

Kartells also function in the sugar, potash, and other trades. There are now about 2,000 Kartells in Germany.

Legal Status of European Associations.—It has been pointed out already that agreements among producers to limit their output, to allot territory, or to distribute business are considered illegal in the United States. To remain within the law they must, therefore, concentrate their attention on fostering the efficiency of their members through exchange of information or by other legal means. They are not allowed to interfere with free competition.

In Europe, agreements among producers to restrain trade are not regarded as illegal, however. For example, in England they are neither legal nor illegal, there being no law on the subject. In Germany they are regarded as legal, and any contract entered into between the Kartell and a member—even for purposes of restricting output—is enforcible at law.

CHAPTER 23

STANDARDIZATION AND SIMPLIFICATION

Standards and grades become important whenever buyers and sellers lose personal contact, as they do in metropolitan, national, or world economy. Sellers are often far removed from the central markets, so that the actual selling must be done for them by hired middlemen. Under such conditions there is no assurance of accurate returns, unless well-defined standards and grades exist. Furthermore, a lack of standards and grades means purchase by inspection, which makes the marketing process slow and cumbersome for the buyers.

One of the principal accomplishments of trade associations and other cooperative organizations has been the standardizing and simplifying of lines of commodities. These two things—standardization and simplification—while closely related, are somewhat different in their results. Standardizing, i.e., the setting of standards for commodities so that their quality will be known at all times, facilitates trading. In that way it lowers the cost of marketing. Simplification, i.e., the elimination of minor variants in a line of commodities, also reduces the cost of trading by making products more easy to identify and to choose between. It is even more effective, however, in reducing costs of manufacturing, through permitting specialization upon a smaller number of patterns.

While much has been accomplished by the organizations discussed in the three preceding chapters, considerable opportunity remains for further elimination of waste. This is especially true in the field of consumer goods, where the manufacturers' blatant and vociferous claims of superiority are often based on minor and inconsequential differences. If standardization and simplification could somehow be carried to the point where emphasis on minor and imaginary differences was abolished, marketing would be greatly simplified and its costs correspondingly reduced.

The present chapter is concerned with the problems arising from any lack of standardization of commodities, and the resultant effect on the performance of the other marketing functions. Since the terms "grading" and "standardization" are often misused, it is necessary at the outset to define clearly their meaning, as used in this book.

Definition of Terms.—

1. *Standards* comprise all the tests used in classifying commodities, usually on the basis of quality. For instance, the tests used in setting up standards for wheat are weight, color, moisture, gluten content, foreign materials, mixture of other grains, heat damage, smut, and weevil damage. Various combinations of these tests make up the wheat standard. For cloth the standard may be based on tests as to texture and strength of fibre, weave, and so on.

2. *Standardization* is the process of determining the standards which shall be used, the relative importance of these standards, and the method of using them. For most agricultural products the government has promulgated certain standards on the basis of which classifications are made. For manufactured products, the standardization is usually done by each producer, the standard usually being represented by some trade-mark or brand. This practice has led to infinite varieties of goods in each market—although the government and trade associations have recently done much to establish standards for manufactured products.

3. A *grade* is a group of standards. For example, No. 1 dark northern wheat must be spring wheat, weighing not less than 58 pounds per measured bushel, containing not more than

14% moisture, and so on. Specific grade requirements for wheat are given in the following table:

GRADE REQUIREMENTS FOR WHEAT

GRADE	MINIMUM TEST WEIGHT PER BUSHEL		MAXIMUM LIMITS OF—								
			Moisture		Damaged Kernels		Foreign Material other than Dockage		Wheats of Other Classes		
	Hard Red Spring	Durum—Hard Red Winter—Soft Red Winter and White	Hard Red Spring and Durum	Hard Red Winter Soft Red Winter and White	Total	Heat Damaged	Total	Matter other than Cereal Grains	Total	Durum in H. R. S. and H. R. W. S. R. W. and/or White in Durum	Durum in Soft Red Winter or White
	lbs.	lbs.	%	%	%	%	%	%	%	%	%
1..........	58	60	14.0	13.5	2	0.1	1	0.5	5	2	2
2..........	57	58	14.5	14.0	4	0.2	2	1.0	10	5	3
3..........	55	56	15.0	14.5	7	0.5	3	2.0	10	10	10
4..........	53	54	16.0	15.5	10	1.0	5	3.0	10	10	10
5..........	50	51	16.0	15.5	15	3.0	7	5.0	10	10	10
Sample Grade	Sample Grade shall be any wheat which does not come within the requirements of any of the grades from No. 1 to No. 5 inclusive, or which has any commercially objectionable foreign odor except of smut, garlic, or wild onions, or is very sour, or is heating, hot, or is otherwise of distinctly low quality, or contains small inseparable stones or cinders.										

The wheat in grades Nos. 1 to 4 inclusive shall be cool and sweet.
The wheat in No. 5 shall be cool but may be musty or slightly sour.

No. 1 Hard Spring shall consist of 85% or more of dark, hard and vitreous kernels and shall have a minimum test weight of 60 pounds; otherwise the requirements for No. 1 Dark Northern Spring, shall apply. No. 1 Hard Spring, No. 1 Dark Northern Spring, and No. 1 Northern Spring may contain not more than 5% of Humpback variety.

No. 1 Amber Durum and No. 1 Durum may contain not more than 5% Red Durum variety.

4. *Grading* is the classifying of products on the basis of accepted standards. Thus, knowing the required standards of wheat, grading refers to the process of testing a particular lot for the various characteristics embodied in the standards, and classifying the product accordingly.

Hence, standardization in its broadest sense involves, (1) the discovery of basic measures or limits to which a certain good must conform, and/or (2) the use of these measures.

Factors Affecting the Development of Grades and Standards.—The development of grades and standards is affected by two groups of factors, the physical characteristics of the commodity, and certain trade factors. The most important physical characteristics are:

1. *Perishability.* Grades are more significant for a durable product, for more permanent quality, than for a perishable product. Further, durability gives inspection value to a commodity over a longer period of time than is the case with perishables. To illustrate, grades are more significant for grain than for cabbage, since the latter is quite perishable and does not have a permanent quality; neither is inspection good for any great length of time in the latter case.

2. *Homogeneity of quality.* The more uniform the quality in a given lot, the more representative are the samples used in grading, and the smaller the size of the necessary sample. A case in point would be the grading of cotton cloth and of potatoes. Grades are also more significant for goods of uniform makeup, due to greater certainty of the quality.

3. *Seasonal variation in quality.* Wide seasonal variation in quality may lead to the adaptation of standards to the products, rather than the grading of products according to the standards. For example, eggs are not graded the same in summer as in winter in some markets, thus making the quality of the products of a given grade uncertain.

There are also certain trade factors affecting the development of grades and standards. Among them are:

1. *Variation in specific requirement of users.* Fairly uniform demand for a product permits the promulgation of a single standard for a product. Many industrial products, for example, are intended for a variety of factories, so that standards must fit the requirement of each individual factory. The result is that production usually will be on a small scale, and that selling by sample must be used.

2. *Volume of business.* A product which is marketed through centralized markets permits the development of effi-

cient standards, so that grading can be done accurately and at a nominal cost. Wheat is a good example of a commodity marketed in quantities which permit adequate grading and inspection facilities in the large central markets. In markets where there are grain exchanges, such facilities are often maintained both by the exchange and by the state or federal government.

3. *Business integrity.* Both honest and dishonest use of grades are equally possible. Honest use of grades is necessary in order to command the confidence of dealers and producers. For example, commission selling of some farm products has fallen into disrepute in some markets because of the lack of adherence to honest grading practices. Much of the butter sent to the New York market brings the same price per pound as it is sold for at retail. This is only possible if there is undergrading of the product when purchased by the wholesaler or overgrading when it is sold to the retail trade.

Industrial Standardization.—Standardization refers not only to agricultural products but also to industrial goods.

"Industrial standardization consists in singling out specific products and materials, in settling upon their performance, properties and dimensions, and in concentrating upon them, both in production and in use, to the end of bringing about the greatest possible industrial efficiency. Such standardization includes:

1. Nomenclature, such as definitions of technical terms used in specifications and contracts, also technical abbreviations and symbols.
2. Uniformity in dimensions necessary to secure interchangeability of parts and supplies, and the interworking of apparatus.
3. Quality specifications for materials and equipment, as composition, form, and structure.
4. Method of tests to determine standards of quality and performance.

5. Ratings of machinery and apparatus under specific conditions.
6. Safety provisions and rules for the operation of apparatus and machinery in industrial establishments. Safety codes and standards of practice."[1]

The Need for Standardization.—One reason for the excellency of the wheat market as a highly competitive organization is the fact that wheat is standardized, and hence may be traded in for future delivery. Conversely, one important reason for the disorganized state of the produce market is the fact that standardization of fruits and vegetables either is not possible at all, or is very inaccurate.

Goods sold on sample need to be standardized if the buyer is to know what to pay for. Not only absolute values but relative values of different grades can be established more accurately if standardization is possible.

When railroads were first built in this country, each company—usually having only a few miles of line—had tracks of different gauge, so that cars could not pass from one line onto the next, with the result that goods shipped long distances had to be unloaded and reloaded several times. The need for standardization in a case of that kind seems obvious; numerous less obvious, and perhaps much less important, needs for standardization of industrial goods are found. For example, it is a noticeable fact that bumpers attached to automobiles are at various heights from the ground, and of various widths. Apparently no two bumper manufacturers have ever thought of making bumpers a standard width. As a result, when cars are parked parallel to the curb, a front bumper is very likely to lock into the rear bumper of the car ahead.

It is generally assumed that standards of quantity are specific and known to all. Many people, however, do not know that there are in the United States today 43 legal bushels. Tin cans, baskets, and other containers are far from uniform.

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[1] U. S. Dept. of Commerce, *Trade Association Activities,* 1927, p. 84.

Hence, dishonest weights and measures are frequent and the need for standardization of quantities is also apparent.

Standardization is essential, therefore, if marketing is to be efficiently carried out, and if costs of distribution are to be reduced. The advantages of standardization have been much less appreciated in marketing than in manufacturing, although the two are complementary. Any lack of standardization in manufactured goods complicates the marketing problem.

Standardization Aids Both Buyer and Seller.—Standardization simplifies the problem of buying and selling. Goods may be bought either by inspection, by description, or by sample. In any case standardization facilitates the exchange. Even when goods are *sold by inspection,* lack of uniform and known standards may prevent the buyer from having any accurate notion of relative values, unless he happens to be an expert in that line. Purchase of clothing is usually by inspection; yet, the lack of definitely known standards prevents any comparison of values, except by the few highly skilled buyers. The term "natural wool" may mean what it says, or it may—and does—mean cloth made mostly of cotton; casual or inexpert inspection of the goods does not necessarily disclose this fact. Much of our produce is bought in the wholesale market by inspection, because the lack of definite standards precludes any other method of purchase. Even with produce, grades might be established by the trade which would be a better guide to consumer purchases than is the casual inspection of the ordinary retail customer.

Sale by description is made possible only by the promulgation of definitely understood standards, and the grading of goods on the basis of such standards. As mentioned before, future trading in certain commodities is possible only because the goods are accurately definable in terms of certain standards. The buying and selling of cash wheat by description has lately become increasingly accurate with the introduction of tests for protein content, which are now an important factor in the determination of wheat prices. Much of the success of advertising—which is one form of sale by description—is dependent upon standardized goods. Individual producers who advertise extensively usually brand their products as an implicit guaranty that they are of uniform, high quality. When consumers know that goods from a certain factory are standardized, they buy those goods by brand.

Sale by sample presupposes standardized goods, of such uniform quality that a single sample suffices to define the good.

"Careful grading is further justified by the opportunity which it affords for selling each grade for its most economical use. The highest quality fruit can be packed in special packages and sold to the trade which is willing and able to pay a premium for it. The ordinary qualities can be sold for the middle-class trade. Culls can be disposed of to canneries or even dumped into a river or otherwise destroyed, for it is often more economical to destroy the poorest quality outright than to mix it with the quality product and thus lower the standard.

"Careful grading in conformity with properly established standards is of further benefit in that it enables producers to secure a premium for products so graded. The demand in many markets is not just for oranges, it is for oranges which conform to certain standards of size, quality, and variety. Producers who know what these demands are, and produce oranges in accordance with the demands, receive a premium for their fruit. California walnuts have attained their present popularity principally because careful grades were established and enforced, thereby enabling the purchaser to secure nuts of a known quality.

"Allied to this advantage is the fact that careful grading of commodities enables producers to create a demand for their particular products. The strong English demand for Danish butter and bacon is a good example. When a group of Minnesota and Wisconsin creameries established certain standards for handling cream and for the butter made from the cream, they were enabled to create a wide demand for their product under the name of Land-O'-Lakes butter and to receive a definite premium for it."[2]

Standardization Effects Economies in Storage.—Standardization permits a better utilization of storage capacity. With farm products, for example, a good deal of storage is necessary, since nearly all are seasonally produced. If standards are available and accurate grading can be done, the products of various individuals may be mixed in the warehouses when grades are the same; the cost of storage is thereby materially reduced. Further, grading of the products on the farms prevents the storing of waste and worthless goods.

Standardization Effects Economies in Transportation.—For the same reasons, the establishment of standards, and grading to conform with such standards, makes possible economies in transportation. With the present high transportation costs, for example, it is often too expensive to ship worthless produce, which could be eliminated through proper grading. The products which cannot economically stand the transportation costs are also often worth more on the farm than they are in the central markets. Further, it is cheaper to ship in carlots than in smaller quantities. Graded goods belonging to different owners may be combined to make carload lots. For example, the possibility of grading accurately each producer's cream permits the mixing of the various lots, so that larger and fewer containers may be used.

Standardization Reduces Risk.—Standardization takes much uncertainty out of business. Market news can reflect actual conditions only if accurate standards are possible. For a farmer to be told that the price of wheat is a certain figure is meaningless; reference must be made to some particular grade and variety. A perusal of any market news sheet shows a wide price range for various grades and classes of most products. A producer contemplating shipping to a particular market is interested in quotations and news for a *definite* product. Hence, intelligent distribution of products can be had only by knowing definitely the grades desired by, and present in, the various markets.

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[2] Maynard, *et al.*, *Principles of Marketing*, pp. 503–504.

Standardization also serves to reduce market risks by making possible a more accurate description of goods, thus widening the market and increasing the possible outlets.

It was pointed out above that hedging is a distinct method of reducing risk. Future trading is possible only when goods can be accurately described on the basis of well-defined standards.

Standardization Facilitates Financing.—Adequate grading makes it possible for owners to borrow larger amounts, and often at lower rates of interest, on goods stored in warehouses. If a grade is well-defined, the market value of the product may be ascertained accurately, and hence serve better as security for loans. The same thing applies also to goods in transit. When goods are loaded, grade certificates attached to the bill of lading serve as a basis for borrowing. A shipper need not in such cases wait until the products are sold to obtain funds.

Standardization Reduces Costs of Marketing.—Standardization is, therefore, highly essential to efficient marketing. The performance of the marketing functions is more costly for goods which are not standardized, as is shown by a comparison of the relative costs of marketing produce, on the one hand, and most manufactured products, on the other. Advertising and large-scale selling are based on highly standardized goods, the demand being created for, and associated with, a particular quality. Likewise, standardized products may gain the confidence of buyers and sellers, eliminating an important obstacle to trading at great distances, and thereby extending the market. Economies in storage and transportation and lessening the risks incidental to ownership of goods are possible only if the goods are definable in fairly accurate terms.

Simplification.—Closely allied to the problem of standardization as a means of reducing marketing costs is that of simplification, which involves the elimination of unnecessary varieties and sizes. The present society is highly competitive, with a consequent struggle on the part of each producer to create a demand for his particular product. In order to advertise successfully, each producer has to have a certain brand and trade name to associate with his product. The result is a multitude of varieties and sizes of similar products, one example of which is the automobile bumpers mentioned above.

Importance of Simplification.—The problem of simplification was most forcefully called to the attention of the public during the late World War, when attention was directed toward the reduction of wastes in industry. A Division of Simplified Practice in the Department of Commerce was established in 1921 as a result of the war studies. The Division conducts surveys in various industries, calling attention to existing duplication of effort, and makes recommendations for simplification. A monthly bulletin discussing various activities undertaken in this connection is available.

Advantages of Simplification.—Simplification is beneficial to producers and distributors alike. For a manufacturer, the savings brought about through a reduction in inventory of material, patterns, and repair parts are considerable. Reduction in number of varieties often makes possible larger-scale production, and often lower costs. European automobile manufacturers, even up to the present time, have each made many models and sizes of automobiles. The factories have as a result turned out relatively few cars per year. Ford's products, on the other hand, have been very limited, enabling large-scale production and economical operation. In general, simplification is advantageous for the manufacturer, both because of a reduction in cost of operation and an increase in turnover.

Distributors also gain from simplification. Faster turnover of stocks of the simplified goods, small stock investment, and less obsolete goods are some of the major sources of gain. Purchasing is much easier, relative values more nearly determinable, and inventories may be cut down. As a result, costs of marketing should be materially reduced. A case in point is afforded by a comparison of operating costs of chain grocery stores and independents. The former generally handle a smaller variety of goods, often only staples, while the latter keep a well-rounded stock on hand at all times. Costs of selling in the independent unit stores are usually higher, even when delivery and bad debts costs are excluded.[3]

An example of the benefits resulting from simplification is furnished by a lamp manufacturer. The general lighting types manufactured were reduced from 1,260 to 180, and lamp bases were reduced from 179 to 3. As a result, the company was able to reduce the price by 50% in twelve years, and sales increased 74% in four years. Transportation and warehousing expenses were reported reduced, floor space more efficiently utilized, and employee efficiency increased.[4]

The Waldorf Astoria chain hotel system estimates that it saves about $100,000 a year by following certain simplified practices. For example, it reduced 30 styles of glassware to 10, 15 designs of carpets to 3, and many patterns of table linen to one pattern. Two hundred other supply items were similarly simplified. Scores of other industries have found a study of possible simplification of line to be worthwhile.

The Government and Simplification.—As mentioned above, the Division of Simplification in the Department of

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[3] E. G. Brown, *Marketing*, pp. 397–398.
[4] From monthly letter of Department of Commerce.

Commerce has been very active in working for simplification. Surveys in various industries have been made, and recommendations sent to large manufacturers and to trade associations for discussion and adoption. If favorable action is taken on proposals, a statement of the acceptance is forwarded to the Division of Simplification, giving that organization a record of accomplishments.

Responsibility for adherence to the recommendation rests with the group which created it—the trade association or manufacturers. Adherence is, of course, not compulsory. The advantage to manufacturers, distributors, and consumers, however, are relied upon to keep all concerned in line. One audit of adherence to recommendations showed it to be 79% in support of 19 simplifications.

Examples of Results of Simplified Practice Recommendations.—The results of the simplification movement have been quite significant in many fields, as indicated by the following figures:[5]

Item	Reduction in Varieties	
	From	To
Blankets (sizes)	78	12
Metal lath	125	24
Hotel chinaware	700	160
Plow bolts	1,500	840
Files and rasps	1,351	496
Sheet steel	1,891	263
Woven wire fence packages	2,072	138

Numerous other examples of successful simplification could be quoted.

Simplification Does Not Mean Uniformity.—It should be pointed out clearly that simplification does not imply the reduction of every product to a single form or size. It takes account of the extent of variety produced, and of the demand for the various items in that variety. It aims to eliminate from that variety the superfluous and slow-moving items, and concentrate the attention of producer and distributor on the "live goods," and thereby reduce costs. As President Hoover has said: "What we are discussing are our economic wastes. They contain the paradox that if we save them collectively we shall have more goods and services to expend individually. We do not by this process propose to abolish Easter bonnets; we propose more bonnets for the same money and effort."

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[5] From publications of Division of Simplified Practice.

Simplification Does Not Shut Off Demand.—In spite of the reduction in varieties and sizes, demand for "special" types is satisfied by paying the higher price necessary to cover the order cost. Simplification is not carried so far, however, but that the majority of the demand is satisfied by the simplified goods. For example, shovels, spades, and scoops were formerly made in 4,460 varieties. Upon investigation it was found that 4,060 of those possible combinations of sizes, grades, and finishes supplied but 7½% of the total volume of business. By cutting the number of varieties from 4,460 to 384, the majority, over 90%, of the demand could still be satisfied—at a much reduced cost.

As another example, one hat manufacturer shortly after the World War was making 3,684 combinations of sizes, styles, and colors of hats. But 90% of his sales were in 7 styles and colors. By greatly reducing the variety he was able to cut his inventory materially.

Approved by labor and indorsed by consumers, simplified practice is now being applied more and more widely to eliminate avoidable waste growing out of the production of needless varieties and sizes of commonplace articles.

Limits of Simplification.—While the gains from simplification are obvious in many lines, no one would prefer extending it to all consumer goods. Uniformity in food and dress, where expression of individual fancy—and oddities—reigns supreme, is, of course, far beyond the fondest hope of the reformer of human nature. Competitive selling with its ally—advertising—has established "specialty" goods and "specialty" stores, and styles and fads pass in a continuous review before a bewildered public. While it is charged that the consumer is at the mercy of the producers of style goods, who live and prosper by making goods obsolete almost before they are worn, nevertheless there must be some room for individuality of expression.

It would seem, therefore, that simplification must be applied with varying degrees of thoroughness to various industries and classes of goods. While cutting down the number of varieties of shoes handled in a large store from 460 to 220 may be a good thing, reducing that number still further would probably not meet with much approval. On the other hand, reducing the varieties of milk-bottle caps from 29 to 1 most likely did not seriously infringe on the individual consumer and his happiness.

Further limitations to simplification—and also to standardizing—are habit and inertia. Cutting down the number of varieties of a certain good may mean a temporary decrease in sales, which short-sighted producers often are not willing to sacrifice. Further, in lines where competition is keen, many producers can gain a little by keeping slightly below standard, and by making their good just a little different.

Conclusion.—Standardization and simplification are complementary improvements in business practices. The advantages to manufacturer, distributor, and consumer alike are easily demonstrable. The adoption of uniform standards and simplified practices is, however, often blocked by the self-interest of one or a few producers, who cannot see any apparent gain from any changes. The government cannot readily compel adherence to certain standards and practices, except in very limited instances.[6] Any changes must, therefore, come about as a result of concerted action by leading producers. Trade associations, and such organizations as the American Engineering Society, have done a great deal during the past few years to standardize and simplify manufactured goods. In addition, the agricultural and consumer cooperatives have done much along the same lines. For example, the California Fruit Growers' Exchange has been instrumental in reducing the number of commercial varieties of oranges grown in California from about fifty to two principal and three or four minor varieties. Also, the British consumer cooperative societies are distributing 60,000,000 pounds of tea annually under only one general brand for each of the standard varieties. Further improvements may be expected when the full benefits of standardization and simplification become known generally.

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[6] Common examples are governmental standards for grain, cotton, and some other farm products.

CHAPTER 24

THE RELATION OF GOVERNMENT TO MARKETING

The Essence of Governmental Regulation.—The present order of society was described earlier in this book as one in which, through the spontaneous action of the individual pursuing his immediate self-interest, there arises cooperation of an advantageous sort, effected and regulated by exchange. There are many points in this system, however, which are influenced and modified by conscious governmental regulation. Certain activities of government in enforcing the rights of free initiative, private property, contract, and exchange, are necessary to allow the automatic principle to work itself out in any really effective manner. Inasmuch as exchange or trade is so important in the operation of the present order, it is but natural that a degree of governmental control of marketing institutions and methods has developed.

In part, governmental regulation appears to be in contradiction to the principle of automatic control. Efforts are constantly directed, with varying success, toward increased economic efficiency, better economic conditions of certain classes, and the safety and well-being of the nation as a whole. In the main, however, these regulations have been called into being by a lack of some of the conditions essential to free competition. The injustice of the dogma "caveat emptor" (the buyer beware!) has been recognized because, as pointed out in connection with consumer cooperation, consumers generally lack sources of information and bargaining power equal to those of sellers. Also, governmental regulation has favored agricultural cooperation because it permits many small producers to compete on equal terms with large, well-informed buyers. Trade associations are encouraged by government in their collection and dissemination of market information because such services improve the conditions of competition.

Necessity for Some Governmental Regulation.—"We look for protection from the predatory interests of individuals through competition. In many cases, however, this protection has broken down. There are many fields of production which are clearly monopolistic. The railroads, public utilities, and a large and growing mass of industries supplying public services are already non-competitive; their monopolistic nature is recognized and society provides safeguards for the consumers by the legal establishment of reasonable rates and minimum qualities of service. In many other industries there are 'trusts,' or less conspicuous organizations, such as trade associations, or even codes of ethics which are designed to lessen the dangers of competition, and to make industry safe for the business man. In the labor field there are strong organizations which occasionally have been responsible for stoppages in certain vital industries because of disputes. Competition has not disappeared entirely, but it has ceased in many cases to provide the safeguards needed by society, and in these cases there is need for control and regulation in the interests of society as a whole. The extent to which the economic society is dependent upon the various sorts of price regulation is indicated in a rough way by the table below."[1] (Page 408.)

On the other hand, when a corporation has become very large and thoroughly established, the old distinction between public and private interest often becomes dim. Possibly it may largely disappear. It is difficult to say whether the great railroads, the General Electric Company, the United States Steel Corporation, the bigger insurance companies and banks

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[1] W. C. Waite, *Economics of Consumption*, pp. 15-16.

RELATIVE AMOUNT OF ECONOMIC OPERATION UNDER DIFFERENT FORMS OF PRICE GUIDANCE

	Per Cent of U. S. Capital	Per Cent of Total Annual production
Freely competing, or fairly so—farming, construction, manufacturing	56%	50%
Some element of monopoly—iron, steel, petroleum	7	7
State regulation of service—banks, insurance	5	5
State control of service and rates—railroads, public utilities	21	8
State production—post office, schools, etc	10	6
Miscellaneous—distribution, etc.		22
	100	100

are public or private institutions. Their legal owners are largely disfranchised, their management is in the hands of salaried executives and technicians, their ultimate control is held in trust by their directors. Such corporations are undertaking programs of social welfare, of education, of retirement benefits, and so on, of the sort which we have long recognized cannot be left to individual initiative. Things which are collectively important, are important to these super-organizations, for, literally, they are "of the people, for the people, by the people." Under these conditions it is not fanciful to say, with Mr. Keynes, that "the battle of socialism against unlimited private profit is being won in detail hour by hour." It seems that government and the machine technology are cooperating in a very real sense to bring about a social ideal.

An Outline of Governmental Activities in Marketing.—"The governmental activities which bear directly on marketing can be conveniently divided into three classes: (1) those which are intended to elevate the plane of competition; (2) those which aim to control monopoly; and (3) those which are planned to promote the technical efficiency of marketing."[2]

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[2] F. E. Clark, *Principles of Marketing,* p. 480.

Professor Clark has outlined these three classes of activities as follows:

I. Government Efforts to Elevate the Plane of Competition

1. Establishment and enforcement of standards
    - (a) Monetary regulation and banking laws
    - (b) Standardization of money, credit instruments, weights, measures, and commodity grades
2. Restriction of unfair trade practices
    - (a) Common law doctrine designed to maintain fair conditions of trade
    - (b) Control of trade practices
        - (1) Federal and state anti-trust acts
        - (2) Federal Trade Commission Act
        - (3) Legislation controlling the activities of produce exchanges and commission merchants
    - (c) Control of transportation rates and services; elimination of discrimination between persons, places, and commodities
    - (d) Statutes concerning patents, copyrights, trade-marks
3. Restraint of fraud, adulteration, and the sale of harmful products
    - (a) Common law doctrine
    - (b) Pure food and drug acts (federal, state, local)
        - (1) City ordinances concerning milk supply
        - (2) Inspection of meat and cold storage products
        - (3) Regulation of the duration of storage
        - (4) Prohibition of the adulteration of products
        - (5) Prohibition of false labeling and false branding
    - (c) Control of weights and measures: including requirement of statement of net contents of packaged goods
    - (d) Certain aspects of state control of banks, insurance companies and building and loan associations
    - (e) United States Bankruptcy Act
    - (f) Blue Sky Laws

II. Efforts to Control Monopolistic Tendencies

1. Sherman Anti-Trust Act, and Clayton Act
2. State anti-trust acts
3. Federal Trade Commission Act
4. Interstate Commerce Commission Act
5. Acts regulating public utilities
    - (a) State railroad and warehouse commissions
6. Wartime activities for price-fixing and rationing in fields normally considered competitive

III. Efforts to Promote Efficiency in Marketing

1. The establishment and enforcement of standards
    - (a) Monetary and banking systems
    - (b) Weights and measures
    - (c) Standard containers
    - (d) Commodity standards
    - (e) Grading and inspection systems
    - (f) Standard bills of lading
    - (g) Standard warehouse receipts
    - (h) Warehouse inspection and license

2. Compelling railroads to unity of action and improvement of service
    - (a) Transportation Act of 1920
    - (b) Public utilities regulation

3. City plans—providing for:
    - (a) Better location of wholesale markets and terminal facilities
    - (b) Establishment of "city markets"

4. Financial activities
    - (a) Federal reserve system
    - (b) War finance corporation
    - (c) State bank control

5. Research, statistical, inspection, and regulative activities
    - (a) Bureau of foreign and domestic commerce
    - (b) Consular service
    - (c) Federal Trade Commission
    - (d) Tariff Commission
    - (e) Bureau of Standards
    - (f) Bureau of Census
    - (g) Bureau of Markets
    - (h) County advisors
    - (i) Universities (state and municipal)

6. Bounties, subventions, tariffs
    - (a) Sugar bounties
    - (b) Ship subsidies
    - (c) Tariff restrictions

7. Restriction of activities of foreign business men in domestic and colonial markets
    - (a) Restrictions on foreign shipping in domestic ports

8. Financial aid to business men
    - (a) War finance corporation
    - (b) Moritoria
    - (c) Ship subsidies

9. Enforcement of contracts

10. Direct assistance to those engaged in marketing
    - (a) Government pamphlets advising of superior methods
    - (b) Parcel post
    - (c) State and federal market bureaus
    - (d) Efforts of state market bureaus and postmasters to bring buyers and sellers together[3]

Influence of Government on the Performance of the Marketing Functions.—From the foregoing list of activities it is seen that all of the marketing functions are affected and modified by governmental influence. The influence on the *functions of exchange* will be discussed later in the chapter under the heads of regulation of trade practices and attempts at regulation of prices. The functions of physical supply are all modified to some extent by governmental action. *Transportation* is subject to regulation by the Interstate Commerce Commission and Commissions in each of the several states, which are charged with the duty of passing on freight rates, abandonment or extension of traffic lines, service, adjustment of rail-and-water rates, and other transportation problems. The significance of such regulation is evident when it is considered that changes in freight rates affect various commodities differently, so that the location of industries and the consequent trade channels are in a large measure dependent upon relative rates. Transportation costs are, moreover, a very important item in the total cost of marketing, so that any modification influenced by governmental action becomes of great significance.

The function of *storage* is likewise influenced by governmental legislation. Pure food and drug acts have been passed to regulate the duration of storage and the sale of storage products. Further, inspectors are provided to test goods going into and out of cold storage. Public warehouses are licensed and inspected by public officials. In some instances, storage rates are regulated by the federal or state government.

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[3] Three additional efforts to promote efficiency in marketing are: (1) the division of cooperation in the Department of Agriculture, which was established to promote and foster cooperative marketing of agricultural products, (2) the Webb-Pomerene Act, which permits joint action of producers in foreign trade, thus promoting exporting, and (3) the Agricultural Marketing Act, which is referred to later in the chapter.

The functions of *standardization* and *grading* are affected in important ways by governmental action, in the effort to promote greater efficiency in marketing. The government has provided standards for weights, measures, and containers in order to provide freer exchange of goods. Standards have been promulgated for many agricultural commodities, thus fixing a definite basis upon which buying and selling may proceed. In addition, governmental inspectors are available to verify the grading of goods consigned to certain central markets. Official certificates of grade are issued by such inspectors, which can serve as evidence in case of dispute between vendor and vendee.

Many acts bearing on the function of *financing* have also been passed. Our monetary and banking systems, without which marketing would be in a stage of barter, are established and regulated under governmental edict.

Finally, through the supervision of the performance of the above-mentioned marketing functions, trade hazards are lessened and uncertainty and *risk* is materially reduced.

Governmental Attempts to Regulate Price.—Some of the governmental enactments have directly affected prices. Tariffs, and the control of freight rates and storage schedules, are illustrations which have already been referred to. During war periods, prices are frequently set by governments in an effort to insure adequate supplies and the desired distribution of those supplies during the emergency. The price of wheat, for example, was fixed by our government during the recent World War. While such interference is not general during peace times, there are frequent attempts to obtain legislation which will stabilize prices or raise the price of certain commodities relative to others. Arguments favoring governmental action almost invariably imply that such policies have been successful in the past and might be again in the future. A survey of the results of the attempts fails, however, to justify the implications.

Examples from Ancient History. Attempts to control prices or supplies, especially of foods, are by no means limited to modern times, for it has long been recognized that the man, or group, who controls the food supply possesses the supreme power. The safe-guarding of the food supply has been, therefore, a concern of governments since they have been in existence.

The well-known story of Joseph shows how the control of the food supply by government reduced a people to slavery. Joseph gathered and stored the harvest for Pharaoh in the years of plenty. The improvident Egyptians lived well and laid by no stores. When famine came they and the people in nearby countries went to Joseph and bought food until their money was gone, then they bartered their cattle, then their land, and finally themselves in exchange for subsistence. Having thus reduced them to slavery, Joseph gave them seed and put them back on what was now government land.

"The history of government limitation of price seems to teach one clear lesson: that in attempting to ease the burdens of the people in a time of high prices by artificially setting a limit to them, the people are not relieved but only exchange one set of ills for another that is greater. Among these ills are (1) the withholding of goods from the market; (2) the dividing of the community into two hostile camps, only one of which considers that government acts in its interests; (3) the practical difficulties of enforcing such limitation in prices which in the very nature of the case requires the cooperation of both producer and consumer to make it effective.

"Egypt took entire control of the grain trade and saved the people from starvation, but took over the land in return.

"China worked out a system of control of supply and demand which kept prices normal. She seems to have been the only country which recognized the whole price question as being a symptom and not the disease itself, and because she recognized this fact seems to have come nearer than any other country to solving the problem of supplying the people with the food they needed at a price they could pay.

"Athens regulated the grain trade and set prices by legal enactment, but found herself unable to enforce them.

"Rome made a colossal experiment in controlling prices by legal enactment, but it utterly failed.

"Great Britain had on her statute books laws fixing the price of bread continuously for more than 500 years. The price of wheat, fish, and wine were also regulated, but all such laws were abrogated in 1815, because of their failure to accomplish the purpose for which they were designed.

"The Dutch Republic was overthrown in 1585, and at least one historian of note declares that price-fixing legislation was largely responsible for its downfall.

"India has learned in the hard school of experience that even in times of famine, price-fixing is a very dangerous expedient because it removes one of the most powerful checks on consumption, namely, high prices.

"The Colonial United States tried the same experiment at various places and times but failed utterly to secure satisfactory results.

"Revolutionary France tried the same measures, but the protagonists of the movement perished on the guillotine. The dreary story of France's efforts to limit prices is distinguished from that of the other countries noted because of the proposal of Barbaroux to enlist the aid of both producer and consumer in the effort of the government to control the food supply in the interest of the people's welfare. The proposition was not carried out but it furnished the first indication of the goal of cooperation toward which we are still pressing."[4]

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[4] Mary G. Lacy, "Food Control During Forty-six Centuries," *Science Monthly,* June, 1923.

Impressive as is this history of failures of governmental regulations of prices, there are still occasional proposals and experiments in this direction. Two of the more important recent schemes are reported briefly. Both of these have proved incomplete and void of permanent benefit to the producers in whose interests they were originally enacted.

The Rubber Control.—Rubber is one of the basic raw materials, which has come into prominence rapidly during the past fifty years, especially since the universal adoption of the automobile. Early in the present century, British capitalists and politicians, recognizing the growing importance of rubber, started plantations in Ceylon and Malay. When these plantations came into bearing, the price of rubber gradually fell, until the plantation industry was in a severely depressed condition. Increase of supply, under the stimulus of high prices at the time plantations were started, had taken place more rapidly than expansion of demand. In 1905, world production was estimated at 61,000 tons, from which it increased to 124,000 tons in 1914, 390,000 tons in 1919, and to 505,000 tons in 1925. In 1912, the price as reported by the *Rubber Age,* was $1.12 per pound, while in 1922 it had fallen to 17 cents.

Legislation for price stabilization was adopted by the British government in 1922. It consisted of a plan to restrict exports. A survey was taken of all plantations in British territory, and an estimate was made of the producing capacity of each. This "standard capacity" became the basis for export regulation. If the price fell below a specified point (between 30 and 36 cents per pound), a supertax, not for revenue but for control of exports, became effective on all exports in excess of a certain percentage of "standard capacity." The further the price fell, the smaller the exports which could be made without payment of the supertax, which tax was heavy enough to make excess shipments unprofitable. This process was to continue until a scarcity of rubber in the world markets forced the price up again to the specified point; control of supply was expected to control price.

One pronounced shortcoming of the plan was that shipments could not be released rapidly enough when demand expanded. In the spring of 1925, two things transpired to test the act and to pave the way for its ultimate withdrawal. By that time, accumulated stocks in world markets had been exhausted so that the demand fell wholly upon current shipments. Moreover, the introduction of balloon tires caused a sudden, extreme increase in demand. As a result, the price rose within a very few months from 30 or 35 cents per pound to $1.20 or even higher. It was not until February, 1926, when 100% of "standard capacity" was released for shipment, that prices again dropped off to more usual levels.

This restriction of supply had a material effect on price, but its indirect effects on world production are also of importance. When the plan was inaugurated, two-thirds of the world's supply of rubber was coming from the British colonies to which the restriction was applied; there was no curtailment of shipments from the Dutch colonies or elsewhere. As a result, the British percentage of world production declined to less than 50%. One direct result of the scheme is the large Firestone development now under way in Africa, and American capital is now undertaking new operations in other countries. Thus the plan built up permanent competition for the colonial industry. The full effects of the plan on the increase of non-British production are not yet in evidence because of the time which must elapse before the new plantations, started as a result of the high prices in 1925, can become productive.

This experience clearly illustrates the impracticability of controlling price without a complete control of supply. The fall in price during 1926 and 1927, together with the increase of competing supply, is just what would be expected whenever outside competition remains. The Stevenson plan has finally been discontinued, partly because it had served its temporary post-war purpose, partly because its futility as a permanent measure was obvious, and partly because the whole attempt was developing international ill-will in the countries which purchased British rubber.

The Coffee Restriction.—In several important respects the coffee situation is similar to the rubber situation. Coffee, like rubber, is a tree crop, and the time required to bring new plantations into bearing is about five years. Established plantations represent a considerable cost, which would be almost completely lost to the owners if they should change to some other crop. In both cases, the bulk of the commodity is sold abroad, and the immediate effect of price control falls largely upon foreign consumers. In both cases also, a large part of the world supply comes from one national source; approximately two-thirds of the world's coffee comes from Brazil and the remainder for the most part consists of coffee which by reason of different flavors and higher prices is not immediately competing.

At the beginning of the present century, coffee plantations were among the most profitable enterprises in Brazil, with the result that large plantings were undertaken. As these plantations came into bearing, the supply of coffee increased faster than the demand so that the price was depressed, especially in years of good crops. Fluctuations in yield have been violent, however, owing to weather conditions and especially to the fact that part of the area is subject to untimely frosts. In the years of large crops the price was depressed, while in the years of small crops the price rose so high as to encourage the use of substitutes. These conditions prompted the Brazilian government to intervene several times with valorization schemes. In each of the large-crop years of 1907–1908, 1917–1918, 1921–1922, it bought large amounts of coffee and with-held the same from the market, financing itself mainly by borrowings in New York and London.

In the first two cases there were short crops in the following years, which permitted the government to sell its accumulations at satisfactory prices. In these cases the attempt to regularize the supply offered for sale was successful, and the results of governmental intervention were satisfactory to producers. The 1921–1922 case, however, was not so fortunate.

In recent years frosts have not been frequent or severe enough to offset the increased yield from new acreage, the planting of which was encouraged by favorable returns following valorization. Experience had taught that efforts to stabilize price depended for their success upon the ability to control the quantity of coffee coming to market. Consequently, an elaborate system was developed—not for the direct control of planting, but for regulating the flow of coffee to ports. Government warehouses were built at strategic interior points, through which all coffee was required to pass en route to the export markets. Each plantation is now allotted a definite share of the total exports and all deliveries to the interior warehouses in excess of these shares are held over until the following season. The shipments out of the warehouses to the ports are made in chronological order, i.e., as the coffee is received from the plantations, and only as the coffee is wanted for export.

The plan has been only partially successful. Although planting is not directly restricted, it has been thought that it would be discouraged through control over marketing. In part, this has been true; the annual production in Brazil increased only from 13,000,000 bags in 1918 to 16,000,000 in 1928. During the same period, production in the rest of the world increased from 6,000,000 to 10,000,000 bags. Brazil's share in the total has been reduced from 68% to 62%.

In 1926 and 1927, the carryover of coffee on the first of each month was never less than 4,000,000 bags. In spite of holding this quantity off the market, the price in 1927 was 10% lower than in 1926 and 20% lower than in 1925. The price strengthened during 1928 and the early part of 1929, but only because more than 8,000,000 bags were carried over into the 1929–1930 crop year. By the close of 1929, the price had dropped to the lowest point since 1923, or to about 60% of the 1928 level.

Thus it is again apparent that governmental attempts to control prices cannot succeed unless they include a direct control of production, or unless, perchance, they bring about a real and continuing increase in demand. When the product consumed has a world-wide production, the attempt of one nation to control the price results mainly in a reduction of the proportion of the total supply produced by that nation.

Neither of the above plans seems practical of application to any of the agricultural crops of the United States. In the first place, export taxes are definitely ruled out by a specific inhibition in our Federal Constitution. Even if this were not so, the United States production is in no case, with the possible exception of cotton, of sufficient importance so that a control of our exports would affect world prices, as did the control of rubber exports. Moreover, an apportionment of crop shipments among the millions of American producers would present problems which seem insurmountable.

The Agricultural Marketing Act.—Ever since the World War there have been urgent requests from many quarters for legislation designed to given financial relief to farmers. This is not the place to discuss the validity of the requests, nor to consider the merits of the various proposals which have been made. Suffice it to say that many of the proposals were rejected because of the belief that they would have boomerang results similar to those in the rubber and coffee control cases. The action which finally was taken by Congress does merit some attention, however.

In 1929 an act was passed by Congress, and signed by President Hoover, creating a Farm Marketing Board. This Board was empowered especially to foster the "orderly" marketing of agricultural products and to this end a loan fund of $500,000,000 was provided. This money was not to be used to finance individuals, but to finance cooperative organizations. It was apparently the intention that the money borrowed by the cooperatives should be used in part to finance the temporary holding of farm products whenever, in the combined judgment of the farmers and the Board, a higher average price to the farmer would result.

It is too early as yet to evaluate the work of the Farm Marketing Board. It seems apparent, however, that the act will be a direct stimulus to cooperation among farmers. Steps were immediately undertaken to create national cooperative organizations to handle the major farm products. It may be worthwhile, therefore, to review the main accomplishments of cooperative associations, with this particular situation in mind. These accomplishments fall under six headings, as follows:

1. Expansion of Demand. The outstanding accomplishment of the successful cooperatives is that they have been able to expand demand as rapidly as supply has expanded. In this connection, it must be remembered that many of the successful cooperatives are dealing with fruits, where from three to six years are required to increase supply materially. Thus, in these cases, demand manipulation has several years' start over the response of supply. Such a situation does not exist with annual crops, such as wheat and cotton, so that the problem of keeping demand ahead of supply is more serious in these latter cases. Moreover, the commercial attempts to encourage the people to "eat more wheat" or to "buy a bale of cotton," generally have been so unsuccessful that similar efforts on the part of cooperatives hold little promise for the staple commodities.

2. Improvement in Quality. Hand in hand with demand manipulation have come improvements in quality. These have been accomplished in part through higher standards and better grading, and in part by improvements in production. Here, again, the opportunities at present available to cooperative organizations are better in the cases of non-staple commodities, sold through unorganized channels, than in the cases of crops sold through organized markets. Moreover, the commodities which are sold as raw materials for processing are already traded on the basis of established standards and grades.

3. "Orderly Marketing." The cooperatives which handle perishable commodities have stabilized prices during a crop year by controlling the flow of the crop to market, both as to time and place of delivery. This has prevented alternate gluts and scarcities with their resulting fluctuation in prices and loss of patronage. Only to a very limited extent, however, have cooperatives been successful in stabilizing prices as between years by adjusting the carryover. In dealing with a single crop year they deal with a visible supply, the total extent of which can be closely estimated. In dealing with a subsequent year, on the other hand, there is no exact knowledge of what the supply will be. Moreover, "orderly marketing" within the season is important with perishables, because they must be consumed soon after receipt. With non-perishables, on the other hand, price is little affected by the rate at which the supply reaches the central markets. The opportunity for gain from the activities of the Farm Marketing Board thus seems to be limited and defined at this point also.

4. Reduction of Expense. In some cases, the cooperatives have been able to modify the marketing channels so that methods have been systematized, contacts have become more direct, and duplication of machinery for the physical handling of commodities has been avoided. Here, again, the most successful work of the cooperatives has been pioneer work in

industries for which the markets had previously been loosely organized. Whether any material improvement can be looked for in the marketing of grain, livestock, cotton, and similar basic products may be questioned, because of the existing efficiency with which these lines are handled.

5. Complete Reflection to the Farmer, of the Central-Market Price. It has been pointed out previously that one reason for cooperative organization is the desire for equality of bargaining ability. When well-informed, central-market representatives are pitted against less well-informed farmers, the price which is paid does not always reflect the central-market price, less the legitimate costs of physical movement to that market. For example, Department of Agriculture studies of the farm marketing of cotton have shown that large variations occur between the prices paid to different farmers in the same town, on the same day, for the same grade of cotton. Extreme cases were found in which the variation was $25 a bale of 500 pounds; variations of $10 per bale were not uncommon. Moreover, much ungraded cotton is sold by farmers. A random sampling of farmer sales in Arkansas in 1918–1919 showed that identical cotton sold for $20 more a bale after grading than before. In cases such as these, the real central-market price was not reflected back to all farmers. Cooperative marketing, with a pooling of product, and well-informed traders in charge of the farmers' sales, might bring to farmers a higher net price in any cases when the conditions just described exist. It is probable, however, that the opportunity for material gain to the farmer is greater in the case of cotton than with any other crop of large volume, owing to the social and financial conditions under which it is produced.

6. Supply Departments. Some successful cooperatives have effected considerable economies for their members through the operation of supply departments. The purchasing

in large quantities of certain supplies, such as salt, packing containers, fertilizers, feed, and so on, and their resale to members at cost, undoubtedly offers an opportunity to the new national cooperatives. Quite material savings for the individual farmer are possible through such activities.

Thus, while the cooperative movement has many desirable features, it is not to be expected that the present governmental fostering of cooperatives can permanently relieve the farmer of his economic problems. In cases where governmentally assisted organizations are able to raise prices relative to costs—thus increasing profits—production is likely to expand, thus reducing prices and profits again. Cooperatives have not, as yet, been successful in controlling production, nor does there appear to be any feature of the present movement which will immediately accomplish such control. It may be fairly questioned, therefore, whether any *more permanent* benefits will be accomplished than in the rubber and coffee cases, except as better marketing methods and the supply departments enable farmers to retain a larger proportion of the consumer's dollar.

Governmental Prohibitions Affecting Marketing.—The more common form of governmental regulation of marketing is that which prohibits or condemns certain acts because they interfere with freedom of competition. For example, the Sherman Anti-Trust Law, passed in 1890, specifies that:

> Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several states, or with foreign nations, is hereby declared illegal. . . .
>
> Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any person or persons to monopolize any part of the trade or commerce among the several states, or with foreign nations, shall be guilty of a misdemeanor. . . .

The Clayton Act of 1914 is more specific when it declares that:

> It shall be unlawful for any person engaged in commerce, in the course of such commerce, either directly or indirectly, to discriminate

in price between different purchasers of commodities, . . . when the effect of such discrimination may be to substantially lessen competition or tend to create a monopoly in any line of commerce: Provided, that nothing herein contained shall prevent discrimination in price between purchasers of commodities on account of differences in grade, quality, or quantity of the commodity sold, or that makes only due allowance for the difference in the cost of selling or transportation, or discrimination in price in the same or different commodities made in good faith to meet competition: And provided further, that nothing herein contained shall prevent persons engaged in selling goods, wares, or merchandise in commerce from selecting their own customers in bona fide transactions and not in restraint of trade.

Finally, the Federal Trade Commission Act states that:

Unfair methods of competition in commerce are hereby declared unlawful.

The Commission is hereby empowered and directed to prevent persons, partnerships, or corporations, . . . from using unfair methods of competition in commerce.

Powers of the Federal Trade Commission.—The methods by which the Commission may proceed in the prevention of unfair practices are given in the following quotations from the act:

Whenever the Commission shall have reason to believe that any person, partnership, or corporation has been or is using any unfair method of competition in commerce, and if it shall appear to the Commission that a proceeding by it in respect thereof would be to the interest of the public, it shall issue and serve upon such person, partnership, or corporation a complaint stating its charges in that respect, and containing a notice of a hearing upon a day and at a place therein fixed at least 30 days after the service of said complaint. The person, partnership, or corporation so complained of shall have the right to appear at the place and time so fixed and show cause why an order should not be entered by the Commission requiring such person, partnership, or corporation to cease and desist from the violation of the law so charged in said complaint. . . . If upon such hearing the Commission shall be of the opinion that the method of competition in question is prohibited by this act, it shall make a report in writing in which it shall state its findings as to the facts, and shall issue and cause to be served on such person, partnership, or corporation an order requiring such person, partnership, or corporation to cease and desist from using such method of competition.

If the order is not obeyed, the Commission may appeal to the Circuit Court of Appeals of the United States for enforcement. Or, the defendant may appeal directly to the same court. In either case, the court may affirm, modify, or set aside the ruling of the Commission, but the findings of the Commission as to facts shall be conclusive.

Interpretation of "Unfair Methods of Competition."—Definition of the term, "unfair methods of competition," has been, and is, in a state of flux. The rulings of the Federal Trade Commission, the adoption of codes of ethics by trade associations, and similar forces are, however, clarifying and stabilizing accepted practices. In the work of the Federal Trade Commission it is found that a smaller percentage of the inquiries are docketed as official complaints each year; in 1921, 50% were so docketed; in 1923, 30%; and in 1928, only 20%. This decrease is accounted for by the fact that, as precedents are established by the commission and the courts, it is possible to dispose of more inquiries without an extensive investigation.[5]

The following announcement, taken from the *Mercantile Adjuster* for December, 1923, illustrates how far the courts are willing to go in protecting established rights of competitors.

"Unfair competition in a novel guise. In Los Angeles, Mr. Charles S. Chaplin, the screen comedian, recently obtained a temporary injunction preventing the showing of films in which one Charles Amador copies the 'Chaplin make-up,' including his famous silly derby hat, half-portion mustache, baggy pants, enormous shoes, and nimble bamboo cane. Amador contended that neither Chaplin, nor any one else for that matter, is entitled to a monopoly of such a make-up, which is said to have been used among the natives even in the time of King Tut-Ankh-Amen.

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[5] See Annual Report of Federal Trade Commission, June, 1928, p. 17.

"Though it would be difficult to cite a case directly in point, it seems clear that the courts should protect the goodwill and good repute which have been built up by Mr. Chaplin in his distinctive make-up on principles of the law of unfair competition. An analogy is found in the case of Weinstock *v.* Marks,[6] decided by the Supreme Court of California. In the Weinstock case the defendant resorted to the erection of a duplicate building alongside the mercantile house of a successful trader. It was built so similar as to deceive the public. Injunctive relief was granted to the plaintiff, and the Court commanded the defendant to distinguish his building from that in which the plaintiff was carrying on his business so as to sufficiently indicate to the public that it was separate."

The list of unfair methods of competition and Clayton Act violations, which have from time to time been condemned by the Federal Trade Commission and prohibited by orders to cease and desist, occupies nearly four pages of fine type in the 1928 report of the Commission. Unfair methods, as established by the Commission, fall into two general classes. The first consists of those practices which are opposed to good morals because characterized by deception, bad faith, fraud, or oppression; the second class includes practices which are thought to be unfair from an economic standpoint because of their tendency to create monopoly.

In connection with the first group of practices the existing moral standards of society have been interpreted and applied in no uncertain terms. The Commission has condemned a long list of practices, including false advertising, sale of adulterated products as pure, the maintenance of bogus independent companies, inducing breach of contract, the payment of money to employees of customers to induce the purchase of goods, espionage, fraudulent demonstration of competitive goods for purposes of disparagement, deceptive imitation of competitive products, false claims of patent, the selling of old or rebuilt goods as new, and so on.

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[6] 109 Cal. 529, 42 Pac. 4 ep., 142.

Typical practices held unfair because of their economic effect are boycotts and blacklists, excessively high bidding to shut off competitors' supplies, the purchase of competitors' goods from dealers to prevent their distribution or use, resale price maintenance systems, division of sales territories, and the like.

The accumulation of precedents in the legal interpretation of unfair competition is both useful and necessary. Market risk arises in part out of uncertainty as to competitors' future actions, and governmental attitude toward such actions. The increasing definiteness of the Commission's rulings provides a clearer basis for anticipating competitors' methods. From time to time these official rulings are supplemented, even anticipated in some cases, by self-regulation within the industry. Such self-regulation may be accomplished through the aid of the Trade Practice Conference Division of the Commission. Generally, it is undertaken directly by a trade association interested in the particular question in hand, through the trade practice conference procedure.

Trade Practice Conference Procedure.—The division of trade practice conferences was organized within the Federal Trade Commission for the purpose of assisting business groups to work out their own trade problems. The division undertakes the details of arranging conferences and also acts as referee. Most important of all, the division is granted the power to enforce any trade practice rules adopted by the conferences and approved by the Commission.

Self-regulation of industry is not a new subject. Trade associations and other business organizations have made attempts in this direction for many years. The procedure under the Federal Trade Commission merely affords a convenient and effective method of arriving at rules and providing for their enforcement.

Self-regulation without rules would be impossible, and rules without some power of enforcement often make self-regulation merely an expensive gesture. The fact that some power rests, as it does, in an impartial governmental body obviates the frequent use of such power. This is demonstrated by the fact that the power of the Federal Trade Commission has been invoked in the enforcement of less than a dozen out of over 300 rules adopted by these conferences.

The rules adopted by trade practice conferences are frequently divided into four groups. Group I, those which have already been approved by the commission; Group II, those received and accepted by the commission as expressions of the trade; Group III, those disapproved by the commission; and Group IV, those held in abeyance without further action by the commission because of lack of agreement between different branches within the industry.

During the year ending June 30, 1928, trade practice conferences were held and regulations adopted by the following: motion picture industry, shirting fabrics industry, golf ball industry, edible oil industry, fur industry, heavy sheet glass industry, hickory-handle branch of the wood-turning industry, millwork industry, waxed paper industry, flat-glass industry, cottonseed oil mills industry, paint, varnish, lacquer and allied industries, rebuilt typewriter industry, and publishers of periodicals. The commission's summary on the shirting fabrics industry is quoted to illustrate the work of such conferences.

> William E. Humphrey, Chairman of the Commission, conducted a trade practice conference for the shirting fabrics industry at the New York office of the Commission on December 10, 1927, assisted by M. Markham Flannery, director of trade practice conferences. Approximately 95%, by volume, of the shirting fabrics industry was represented.

The rules were arranged into two groups (corresponding to the first two groups given above) and became effective two weeks from the date of approval.

At this conference the industry condemned by a rule classified as Group I rule the misbranding of merchandise on the part of the convertors, shirting manufacturers, and others, and pledged themselves to make every effort within their power to discourage and stamp out this serious evil existing in that industry.

By a second Group I rule a discriminatory practice, resulting from using New York as a basing point for the shipping of shirting fabric, was also completely abandoned. Prior to this conference shirting fabric shipped from New England or from the South was delivered in New York City without charge for either freight or drayage. Shirting fabric shipped to any other city in the United States was subject to an arbitrary freight charge and drayage charge. This practice was regarded as discriminatory because charges were made for freight that exceeded the amount of freight actually paid. To correct this evil the rule adopted by the industry provided for the shipment of all shirting fabric f.o.b. point of origin. This rule follows the doctrine in the Pittsburgh Plus case and others involving the same principle.

This conference was held for that branch of the industry known as "convertors" or those who buy the plain fabric from the mill and by finishing, dyeing, printing, etc., convert it into shirting. Prior to this conference great quantities of such material were used in furnishing large samples free of cost to dealers which, with each order received, were shipped throughout the United States. The gratuitous furnishing of these samples was in the nature of a service. Being "free" it developed to an alarmingly extensive and ever-increasing growth, superinduced by intensive competition. Its entire burden rested solely on the convertors who paid the mill for the enormous yardage annually used for this purpose. A rule was adopted by the industry and classified by the commission as a Group II rule which limits the quantity of such samples that may be given free and compels individual requirements in excess thereof to be supplied by the convertor at the sales price of the fabric. The burden, huge in the aggregate, becomes insignificant when thus divided among thousands of distributors and obviates any tendency on this ground toward a demand for higher prices, which, naturally, would be passed on to the public.

By another Group II rule, concerns which spend time and money perfecting a desirable pattern, which they use on a superior quality of fabric only, are protected against the unscrupulous who made a practice of imitating the design, using inferior dyes of the same color, and printing it on lower-grade fabric. This practice, prevalent on the New York market prior to the conference, is reported as having disappeared entirely therefrom after a single informal action taken through the division of trade practice conferences relating to the violation of this rule.[7]

Procedures of this sort emphasize the point made earlier in the chapter, that government and business are cooperating to bring about a social and economic ideal. Here it is seen that not only the extremely large corporations, but associations of business men generally, have common ideals. They cooperate in the removal of uncertainty regarding each other's actions. They set up rules in the interest of the trade as a whole, the keeping of which becomes largely a matter of honor. In this regard the struggle for markets appears to have proceeded from the old régime of "dog eat dog," through the age of "live and let live," into the golden era of "live and *help* live."

Protection of the Consumer.—Stuart Chase, in *The Tragedy of Waste,* opens the chapter on "Wastes in Consumption" as follows: "There is room for improvement in consumption in two general directions—first, the abolition of vicious, harmful, and unnecessary products; second, more intelligence in selection among genuinely good products. The former may be illustrated by labor power lost in the production of useless patent medicines; the latter, by buying rosy cheeked apples (with cotton-wool filling), when green or yellow cheeked apples have twice the food value."

Consumers are protected to a marked degree in both of these directions by the commission's rulings. Goods must be true to name and standard; descriptions must be correct and accurate; deceptive imitation is prohibited; false and misleading claims of results to be expected are condemned; price agreements and price manipulations are illegal. In these and other ways the attempt is made to give to the consumer information which will correctly guide him in his choice between the offerings of various sellers. In spite of these safeguards, however, there are many cases, especially with branded commodities, when the consumer is forced to buy while woefully lacking in market information.

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[7] Annual Report of Federal Trade Commission, 1928, pp. 9–10.

In trade practice regulations, as in control of supply and price, the rights of consumer and producer both should be considered. The question may fairly be raised whether any system which is based largely upon conferences among producers will give full consideration to the consumers' side of the problems of distribution. Nor is the producers' point of view offset by a strong consumer organization in this country as is the case where the consumer cooperative societies are strong.

The trade conference movement seems to be the dominant, controlling force in molding trade ethics within the United States at present. Business is organized in the interests of business rather than of the consumer directly. The American assumption is that if production under competition is healthily prosperous, consumers must be prosperous as well, for, as stated before, production is the measure of consumptive capacity.

The fact that the real income in the United States is higher than anywhere else in the world, and that there has been a material increase in real income during the past few years, may be taken to indicate the soundness of the American point of view. That the American system of control has not been entirely satisfactory from a social point of view is indicated, however, by the fact that there is tremendous inequality of income, together with much unemployment and actual suffering, and that this inequality apparently is not decreasing.

CHAPTER 25

FINAL CRITICISM

The Field Covered.—Modern society, in many of its aspects, is a dynamic, kaleidoscopic affair. This is as true in the market place as anywhere. Here it is that men match wits against each other, dreams find expression in tangible goods, whims and fancies of a fickle public are catered to, millions are made or lost in speculation on the interplay of supply and demand, and the habits of a nation find means for expression. And there is much of romance—and tragedy—and comedy, if you will—in the market places of the world, whether it be the highly organized Chicago Board of Trade or the bazaars of Bagdad.

Marketing is the crux of present-day social organization. In years gone by, when families produced only for their own requirements, there was no need for a focal point, or center, for the exchange of goods. That situation might be likened to the Arch of Ctesiphon, built by an ancient king on the banks of the Tigris, in whose huge, but beautiful, curve there is no keystone. Generations of engineers have wondered how the bricks were held in place. So we might wonder how society could continue without the market—the market as a *place* for traders to meet—the market as a connected *organization* to move goods from producer to consumer—the market as a *price mechanism* which controls the production and consumption of mankind. The market is indispensable to the present automatic-exchange order of society.

The Marketing Functions.—Even though some new sociopolitical development should supplant the present order—

socialism, communism, or other ism—the *marketing functions* would remain. Goods would need to be sought out and called to the attention of potential users. This is true for all sorts of commodities and services. "On a normal Saturday afternoon or Sunday in New York, it takes from an hour and a half to three hours by automobile to get beyond the densely populated sections of the city by any of the well-known arteries of traffic. On Broadway and the Grand Concourse, for example, the traffic moves only a few blocks and is halted. Not three blocks east of Broadway it is possible to pass for more than five miles without a stop. So close, in fact, is this little-used road, that a motorist driving along it can see the blocked traffic on Broadway at many points.

"If this road were privately owned and operated as a toll road, obviously, in a very short time its existence and advantages to the motorist would be made known. These advantages could be figured in dollars and cents and in human satisfactions. . . . In industry competition insures us against such a situation. On practically every commercial commodity we are informed and kept informed."[1] This function of keeping users informed will exist regardless of the social structure.

Moreover, a need for transportation, storage, standardization, and financing would remain. Lacking omnipotence, risk, also, would still be present, to be carried by some one. The writers of this book take the continuance of these *functions* for granted, but they also undertake to show some of the changes which are taking place in the methods of performing the functions.

Changes in Demand.—One of the outstanding causes of new methods in marketing is the change in *consumer demand.* The ability of people to buy goods has increased enormously during the past few years. For example, in the last five-year period for which information is available, there was an increase of over 4 million families in the United States with incomes of over $2,000 a year; the registration of passenger automobiles increased from 8 millions in 1920 to 21 millions in 1928; the expenditure for education increased from $780,000,000 in 1913–14 to $2,744,000,000 in 1925–26; the retail sales of electrical household appliances increased from $178,000,000 in 1922 to $361,000,000 in 1927; the physical output of all industries of the United States increased 175% during the first quarter of the present century, and 29% from 1919 to 1925.

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[1] Quoted from Stanley Resor in his Introduction to *The Consumer Looks at Advertising,* by P. T. Cherington.

Changes in demand have been qualitative as well as quantitative. Only 10% of automobiles produced in 1919 were closed cars, compared with 83% in 1928; domestic consumption of rayon changed from 9 million pounds in 1919, to 96 million in 1927; in 1922 radio sales at retail totaled $60,000,000, while in 1926 they were $500,000,000; the number of cigars produced in 1925 was slightly less than in 1909, while the number of cigarettes had increased 12-fold; the per capita consumption of wheat flour fell 25% during the first quarter of the century, while that of meat stayed almost constant and that of sugar increased over 50%.

Some of these changes have taken place coincident with efforts to *manipulate demand*; others have come in spite of ardent efforts to maintain the status quo of consumption. All of them emphasize the desirability of *market research,* to aid in anticipating changes in demand, and of setting up *market structures,* such as the commodity exchanges, which will provide free interchange of complete and accurate information. These measures, together with *standardization of commodities,* will do much to lessen *market risk. Cooperation,* whether of producers or consumers, may also tend to equalize competition and lessen risk.

Changes in Retail Trading Areas.—*Transportation* is one of the necessary functions of marketing. But fundamental changes in the performance of this function are in evidence. Private transportation, in the form of the passenger automobile, is shifting trade in many lines of merchandise away from the crossroads stores, village stores, and small towns, to the county seats. In fact, the shift appears to continue toward the larger centers to the advantage of the large metropolitan markets. On the other hand, there is a noticeable development of suburban shopping districts surrounding the larger cities, brought about in part by the traffic congestion in loop districts.

This tendency away from the small town, together with the development of motor trucking for short distances, has greatly reduced the short-haul business of the railroads, although the amount of through freight carried is greater than ever before. Such changes cause constant readjustment of business undertakings.

Hand-to-Mouth Buying.—*Analysis of costs* of marketing, also, has resulted in changes in methods. In this connection, no development is more conspicuous than the tendency toward hand-to-mouth buying. The practice of carrying smaller inventories in relation to sales is especially noticeable with industrial companies, but it is also clearly present with department stores, mail-order houses, and some chain stores.

"The net effects of hand-to-mouth buying during the period from 1922 to 1927 cannot be measured precisely. On the one hand, the selling, buying, and handling expenses of numerous companies were increased thereby. On the other hand, the capital and credit requirements for financing inventories were lightened in the aggregate; the evils of returning merchandise for credit probably were lessened in wholesale trade; and the depreciation of merchandise subject to rapid style changes was minimized. Hand-to-mouth buying, in fact, was in considerable measure a means of defense against rising costs during a period when changes in demand were resulting in a large increase in the varieties of merchandise offered for sale and in rapidly changing styles, and when prices of staple merchandise either were stationary or tending to decline. The lightening of the demand for capital and credit, however, probably was the chief result of hand-to-mouth buying, and that lightening of the demand for capital and credit must have been a large factor in facilitating industrial expansion and the rise in security prices."[2]

The Efficacy of Automatic Exchange Cooperation.—Enterprise is said to be controlled and regulated by two forces—the one automatic and the other governmental. Economists since the time of Ricardo have generally held that individual initiative in the production and interchange of commodities, expressing itself through price, offers adequate control of human activities. People will pay for things just what those things are worth to them, and no one can collect more than that worth. If people are willing to pay materially more than the cost of production for a given stock of goods, then more producers are attracted into the field until wants are satiated and prices fall. *Price,* thus, becomes the *regulator between supply and demand.* A few years ago, for example, an outbreak of foot-and-mouth disease resulted in the slaughtering of several large dairy herds, with a resultant reduction in the supply of market milk. Immediately the price of milk in the neighboring cities was advanced 2 cents a quart in order to curtail the consumption to the proper point. A material falling off in consumption of milk resulted, thus illustrating the regulating effect of price.

There are, however, many points in which this type of control is inadequate. Long ago it was decreed by organized governments that labor expended in highway robbery should be paid for by free lodgment in jail rather than by the retention of the stolen goods. Social interests are thus recognized as distinct from individual interests. While probably these two things coincide in the majority of cases, they do so in no small measure because of habits and the fear of consequences which follow the breaking of social habits. It is neither logically axiomatic nor biologically true that the desire for private gain will prevent people from doing many socially detrimental things.

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[2] National Bureau of Economic Research, *Recent Economic Changes,* pp. 360–361.

If competition is to perform the protective function attributed to it, there must be: first, an interest and willingness on the part of buyers and sellers to discriminate against those who disregard the common welfare, in favor of those who protect it; second, possession of sufficient information concerning goods, prices, and the policies of industrial enterprises to make intelligent discrimination possible; and third, substantially equal ability to take advantage of opportunities to buy or sell, or to postpone either operation if the terms are not favorable. Only under these conditions is a *perfect market* possible.

Clearly in our modern market these ideals do not always exist. For instance, engineers will agree that some regulated development of oil fields or cutting of forests represents social efficiency; but we buy gasoline and lumber from the producer who sells for the lowest price today, never thinking to boycott him for his disregard of tomorrow. In long-time enterprises, free competition frequently exercises poor control.

Moreover, it is patent that desires are often manipulated by sellers toward goods which are socially detrimental; and consumers in whom such wants have been aroused do not discriminate against those who cater to them. It is generally agreed that those who traffic in whiskey and opiates are inclined to overstimulate desires; and mechanistic economics offers no relief from this situation. Modern business reeks with this particular failure, in cases of more or less importance. Men are persuaded, often against their original will and judgment, to attach great importance to style changes in clothes, to high-powered automobiles, to pretentious dwelling houses, to chewing gum, and comparatively little importance to intellectual, aesthetic, or moral interests. All this is done, unchecked by mechanistic economics, for the hope of private gain; and yet no philosophy can defend such a scale of values.

It would be both cheap and false to say that "what the people want they should have"; it is inconsistent, in addition, to claim that our present system gives people what they want and to say, at the same time, that advertising molds peoples' desires and habits. The latter is frequently true—to the profit of the advertisers. At the present stage of development of the human race, the masses follow leaders, and today the leaders are likely to be advertisers in search of a profit.

However, it has been rightly said that the most valuable resource of any country is its fund of human energy, that is, the working power, both mental and physical, of its people. And so far in the world's history it appears that the hope of profit has done more to keep the mass of men everlastingly at some task than has any other force. While the social organism has already declared certain forms of enterprise for profit so injurious that they must be abolished, it has not so declared against those things which are merely wasteful. When economic pressure becomes greater it is possible that mechanistic values will force such things out of existence, but it is more than probable that *governmental regulation* will be required to direct human energy into the least wasteful channels, because such regulation crystallizes the opinions and ideals of the leaders in social thought.

The Public Point of View.—One is constantly impressed by the extent to which governmental regulation has already entered the field of marketing. Transportation rates and services are rigidly controlled. Storage and finance companies are inspected and supervised. Governmental standards of quantity and quality have been set up for many commodities. Health is somewhat safeguarded by food and drug inspection. Produce exchanges are supervised. The charges for gas, electricity, and water are set by commissions. Unfair competition, including misleading advertising and other misrepresentations, is enjoined. Market news, including crop estimates, sources of supply, costs of operation, and so on, is gathered and broadcast by governmental agencies. Tariffs and subsidies are direct attempts to influence price.

Every one of the marketing functions is occasionally performed and partially controlled by government. It is conceivable that such control may go further in the future. The number of retail outlets, for example, might be limited in accordance with studies on the most efficient size of store. Competitive advertising between manufacturers of two essentially similar brands of a product—paint for instance—might be curtailed. Commodity prices might be regulated through a control either of production or of sale.

With the present temper of the American people it seems more probable, however, that *cooperative,* rather than governmental, effort will continue to control a large portion of the marketing activities. Cooperation in the technical sense, as manifested by the agricultural associations, the chain store groups, and the trade associations, seems destined to play a continuingly large part in market control.

It has long been felt that one of the main opportunities for economy lies in *large-scale and integrated enterprises.* At present, advertising is insistently employed to attract a large clientele to individual concerns so that these economies may be realized. The constant difficulty with this situation is that the quest for private gain develops monopolistic evils associated with large operations, against which governments feel impelled to protest. Just at present a veritable avalanche of consolidations and integrations is taking place, in the field of marketing as well as elsewhere. If the established American policy of prohibiting all collusions which appear to influence price is to be maintained, this movement toward consolidation will make inevitable a greater degree of state—as distinguished from automatic—regulation.

APPENDIX A

MARKETING CHANNELS FOR COMMODITIES

There are many channels through which commodities travel from the producer to the consumer. The complexity of these channels is shown by the following diagrams, taken from the report of the Joint Commission of Agricultural Inquiry, on Marketing and Distribution (1922).

Diagram 1. Distribution of Agricultural Products
2. Distribution of Wheat and Wheat Products
3. Distribution of Fruits and Vegetables
4. Distribution of Wool and Wool Products
5. Distribution of Cotton and Cotton Products
6. Distribution of Dairy Products
7. Distribution of Livestock and Livestock Products

Diagram 1.

DISTRIBUTION OF AGRICULTURAL PRODUCTS.

JOINT COMMISSION OF
AGRICULTURAL INQUIRY

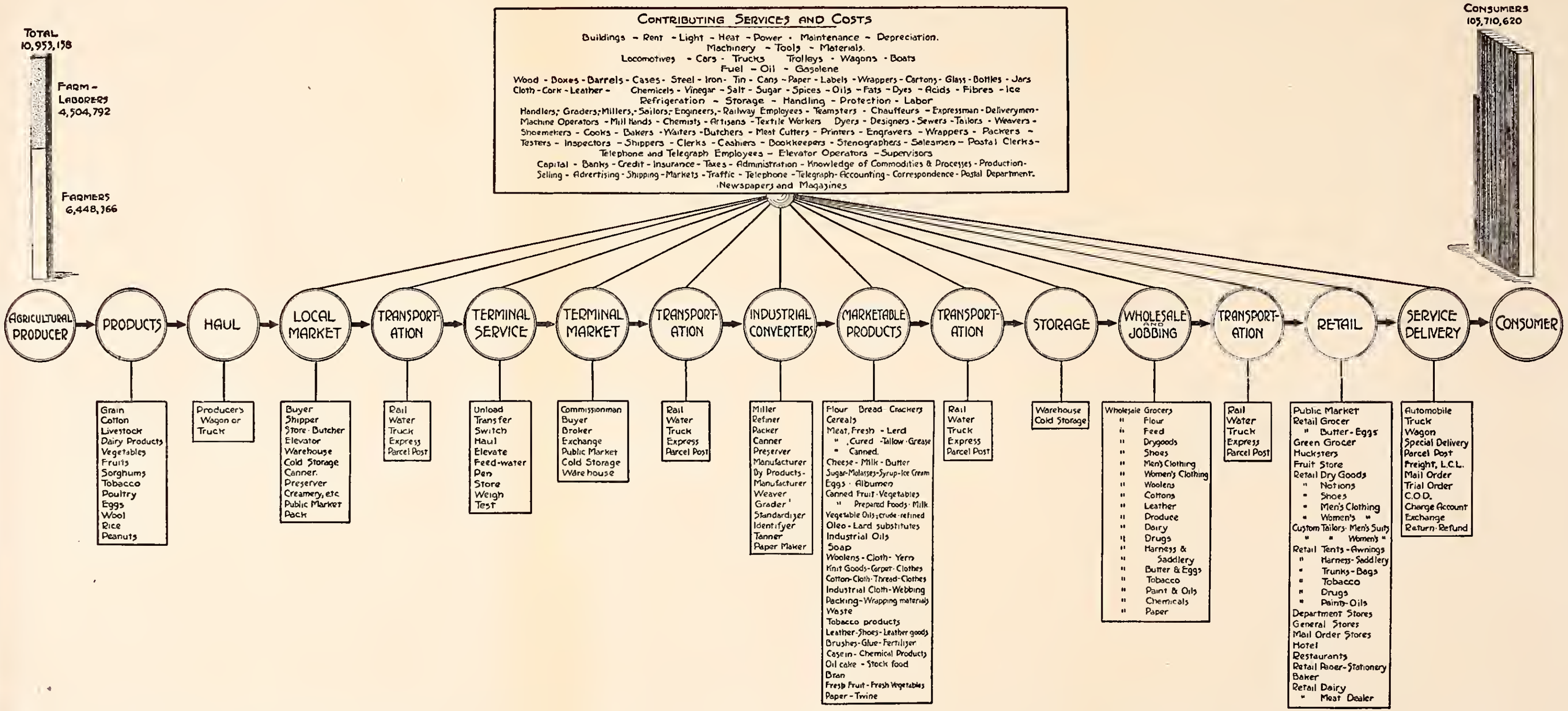

TOTAL 10,953,158
FARM-LABORERS 4,504,792
FARMERS 6,448,366
CONSUMERS 105,710,620
CONTRIBUTING SERVICES AND COSTS
Buildings - Rent - Light - Heat - Power - Maintenance - Depreciation.
Machinery - Tools - Materials.
Locomotives - Cars - Trucks Trolleys - Wagons - Boats
Fuel - Oil - Gasolene
Wood - Boxes - Barrels - Cases - Steel - Iron - Tin - Cans - Paper - Labels - Wrappers - Cartons - Glass - Bottles - Jars
Cloth - Cork - Leather - Chemicals - Vinegar - Salt - Sugar - Spices - Oils - Fats - Dyes - Acids - Fibres - Ice
Refrigeration - Storage - Handling - Protection - Labor
Handlers,- Graders,-Millers,-Sailors,-Engineers,-Railway Employees - Teamsters - Chauffeurs - Expressman - Deliverymen -
Machine Operators - Mill Hands - Chemists - Artisans - Textile Workers Dyers - Designers - Sewers - Tailors - Weavers -
Shoemakers - Cooks - Bakers - Waiters - Butchers - Meat Cutters - Printers - Engravers - Wrappers - Packers -
Testers - Inspectors - Shippers - Clerks - Cashiers - Bookkeepers - Stenographers - Salesmen - Postal Clerks -
Telephone and Telegraph Employees - Elevator Operators - Supervisors
Capital - Banks - Credit - Insurance - Taxes - Administration - Knowledge of Commodities & Processes - Production -
Selling - Advertising - Shipping - Markets - Traffic - Telephone - Telegraph - Accounting - Correspondence - Postal Department.
Newspapers and Magazines
AGRICULTURAL PRODUCER
PRODUCTS
HAUL
LOCAL MARKET
TRANSPORTATION
TERMINAL SERVICE
TERMINAL MARKET
TRANSPORTATION
INDUSTRIAL CONVERTERS
MARKETABLE PRODUCTS
TRANSPORTATION
STORAGE
WHOLESALE AND JOBBING
TRANSPORTATION
RETAIL
SERVICE DELIVERY
CONSUMER
Grain
Cotton
Livestock
Dairy Products
Vegetables
Fruits
Sorghums
Tobacco
Poultry
Eggs
Wool
Rice
Peanuts
Producers Wagon or Truck
Buyer
Shipper
Store - Butcher
Elevator
Warehouse
Cold Storage
Canner.
Preserver
Creamery, etc
Public Market
Pack
Rail
Water
Truck
Express
Parcel Post
Unload
Transfer
Switch
Haul
Elevate
Feed-water
Pen
Store
Weigh
Test
Commissionman
Buyer
Broker
Exchange
Public Market
Cold Storage
Warehouse
Rail
Water
Truck
Express
Parcel Post
Miller
Refiner
Packer
Canner
Preserver
Manufacturer
By Products - Manufacturer
Weaver
Grader
Standardizer
Identifyer
Tanner
Paper Maker
Flour Bread - Crackers
Cereals
Meat, Fresh - Lard
" , Cured - Tallow - Grease
" Canned.
Cheese - Milk - Butter
Sugar - Molasses - Syrup - Ice Cream
Eggs - Albumen
Canned Fruit - Vegetables
" Prepared Foods - Milk
Vegetable Oils; crude - refined
Oleo - Lard substitutes
Industrial Oils
Soap
Woolens - Cloth - Yarn
Knit Goods - Carpet - Clothes
Cotton - Cloth - Thread - Clothes
Industrial Cloth - Webbing
Packing - Wrapping materials
Waste
Tobacco products
Leather - Shoes - Leather goods
Brushes - Glue - Fertilizer
Casein - Chemical Products
Oil cake - Stock food
Bran
Fresh Fruit - Fresh Vegetables
Paper - Twine
Rail
Water
Truck
Express
Parcel Post
Warehouse
Cold Storage
Wholesale Grocers
" Flour
" Feed
" Drygoods
" Shoes
" Men's Clothing
" Women's Clothing
" Woolens
" Cottons
" Leather
" Produce
" Dairy
" Drugs
" Harness & Saddlery
" Butter & Eggs
" Tobacco
" Paint & Oils
" Chemicals
" Paper
Rail
Water
Truck
Express
Parcel Post
Public Market
Retail Grocer
" Butter - Eggs
Green Grocer
Hucksters
Fruit Store
Retail Dry Goods
" Notions
" Shoes
" Men's Clothing
" Women's "
Custom Tailors - Men's Suits
" " Women's "
Retail Tents - Awnings
" Harness - Saddlery
" Trunks - Bags
" Tobacco
" Drugs
" Paints - Oils
Department Stores
General Stores
Mail Order Stores
Hotel
Restaurants
Retail Paper - Stationery
Baker
Retail Dairy
" Meat Dealer
Automobile
Truck
Wagon
Special Delivery
Parcel Post
Freight, L.C.L.
Mail Order
Trial Order
C.O.D.
Charge Account
Exchange
Return - Refund

Diagram 2.

DISTRIBUTION OF WHEAT AND WHEAT PRODUCTS

JOINT COMMISSION OF AGRICULTURAL INQUIRY

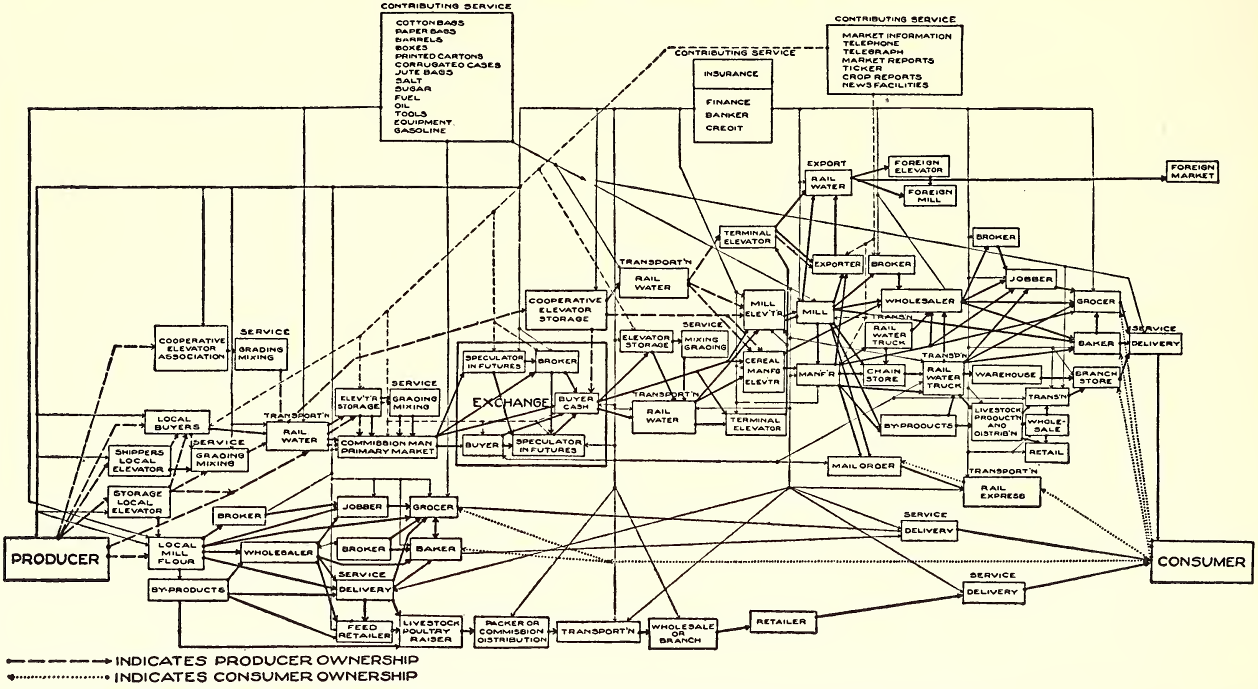

CONTRIBUTING SERVICE
COTTON BAGS
PAPER BAGS
BARRELS
BOXES
PRINTED CARTONS
CORRUGATED CASES
JUTE BAGS
SALT
SUGAR
FUEL
OIL
TOOLS
EQUIPMENT
GASOLINE
CONTRIBUTING SERVICE
INSURANCE
FINANCE
BANKER
CREDIT
CONTRIBUTING SERVICE
MARKET INFORMATION
TELEPHONE
TELEGRAPH
MARKET REPORTS
TICKER
CROP REPORTS
NEWS FACILITIES
PRODUCER
COOPERATIVE ELEVATOR ASSOCIATION
SERVICE
GRADING MIXING
LOCAL BUYERS
SHIPPERS LOCAL ELEVATOR
SERVICE
GRADING MIXING
STORAGE LOCAL ELEVATOR
BROKER
LOCAL MILL FLOUR
WHOLESALER
BY-PRODUCTS
TRANSPORT'N
RAIL WATER
ELEV'T'R STORAGE
SERVICE
GRADING MIXING
COMMISSION MAN PRIMARY MARKET
JOBBER
GROCER
BROKER
BAKER
SERVICE
DELIVERY
FEED RETAILER
LIVESTOCK POULTRY RAISER
PACKER OR COMMISSION DISTRIBUTION
TRANSPORT'N
WHOLESALE OR BRANCH
RETAILER
EXCHANGE
SPECULATOR IN FUTURES
BROKER
BUYER CASH
BUYER
SPECULATOR IN FUTURES
COOPERATIVE ELEVATOR STORAGE
TRANSPORT'N
RAIL WATER
ELEVATOR STORAGE
SERVICE
MIXING GRADING
TRANSPORT'N
RAIL WATER
TERMINAL ELEVATOR
TERMINAL ELEVATOR
MILL ELEV'T'R
CEREAL MANFG ELEVTR
EXPORT
RAIL WATER
FOREIGN ELEVATOR
FOREIGN MILL
FOREIGN MARKET
EXPORTER
BROKER
MILL
MANF'R
WHOLESALER
TRANS'N
RAIL WATER TRUCK
CHAIN STORE
TRANSP'N
RAIL WATER TRUCK
WAREHOUSE
BY-PRODUCTS
LIVESTOCK PRODUCT'N AND DISTRIB'N
WHOLE-SALE
RETAIL
TRANS'N
MAIL ORDER
TRANSPORT'N
RAIL EXPRESS
BROKER
JOBBER
GROCER
BAKER
BRANCH STORE
SERVICE
DELIVERY
SERVICE
DELIVERY
SERVICE
DELIVERY
CONSUMER
INDICATES PRODUCER OWNERSHIP
INDICATES CONSUMER OWNERSHIP

Diagram 3.

DISTRIBUTION OF FRUITS AND VEGETABLES

JOINT COMMISSION ON AGRICULTURAL INQUIRY

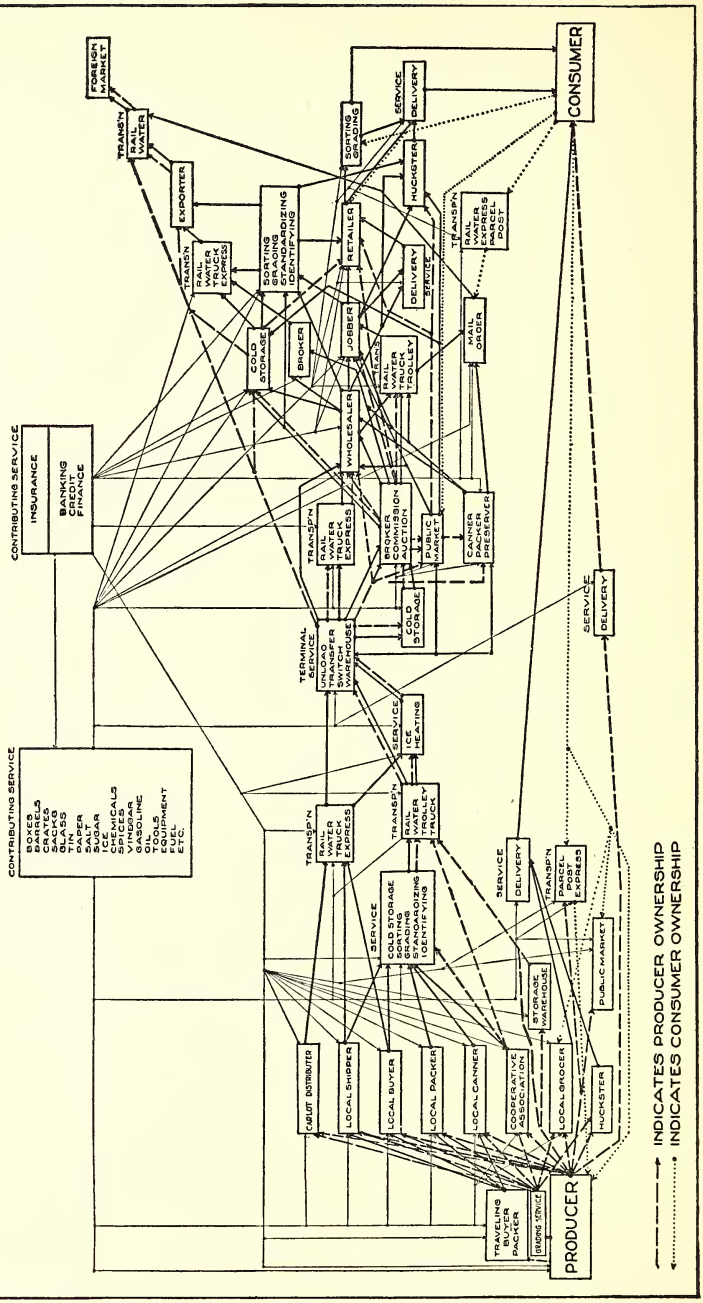

CONTRIBUTING SERVICE
INSURANCE
BANKING CREDIT FINANCE
CONTRIBUTING SERVICE
BOXES BARRELS CRATES SACKS GLASS TIN PAPER SALT SUGAR ICE CHEMICALS SPICES VINEGAR GASOLINE OIL TOOLS EQUIPMENT FUEL ETC.
FOREIGN MARKET
TRANS'N RAIL WATER
EXPORTER
TRANS'N RAIL WATER TRUCK EXPRESS
SORTING GRADING STANDARDIZING IDENTIFYING
COLD STORAGE
BROKER
JOBBER
RETAILER
SORTING GRADING
SERVICE DELIVERY
HUCKSTER
DELIVERY SERVICE
TRANS'N RAIL WATER TRUCK TROLLEY
TRANSP'N RAIL WATER EXPRESS PARCEL POST
MAIL ORDER
CONSUMER
WHOLESALER
TRANSP'N RAIL WATER TRUCK EXPRESS
BROKER COMMISSION AUCTION
PUBLIC MARKET
CANNER PACKER PRESERVER
COLD STORAGE
TERMINAL SERVICE UNLOAD TRANSFER SWITCH WAREHOUSE
SERVICE ICE HEATING
SERVICE DELIVERY
TRANSP'N RAIL WATER TRUCK EXPRESS
TRANSP'N RAIL WATER TROLLEY TRUCK
SERVICE COLD STORAGE SORTING GRADING STANDARDIZING IDENTIFYING
SERVICE DELIVERY
TRANSP'N PARCEL POST EXPRESS
PUBLIC MARKET
STORAGE WAREHOUSE
CARLOT DISTRIBUTER
LOCAL SHIPPER
LOCAL BUYER
LOCAL PACKER
LOCAL CANNER
COOPERATIVE ASSOCIATION
LOCAL GROCER
HUCKSTER
TRAVELING BUYER PACKER
GRADING SERVICE
PRODUCER
INDICATES PRODUCER OWNERSHIP
INDICATES CONSUMER OWNERSHIP

Diagram 4.

DISTRIBUTION OF WOOL AND WOOL PRODUCTS

JOINT COMMISSION ON AGRICULTURAL INQUIRY

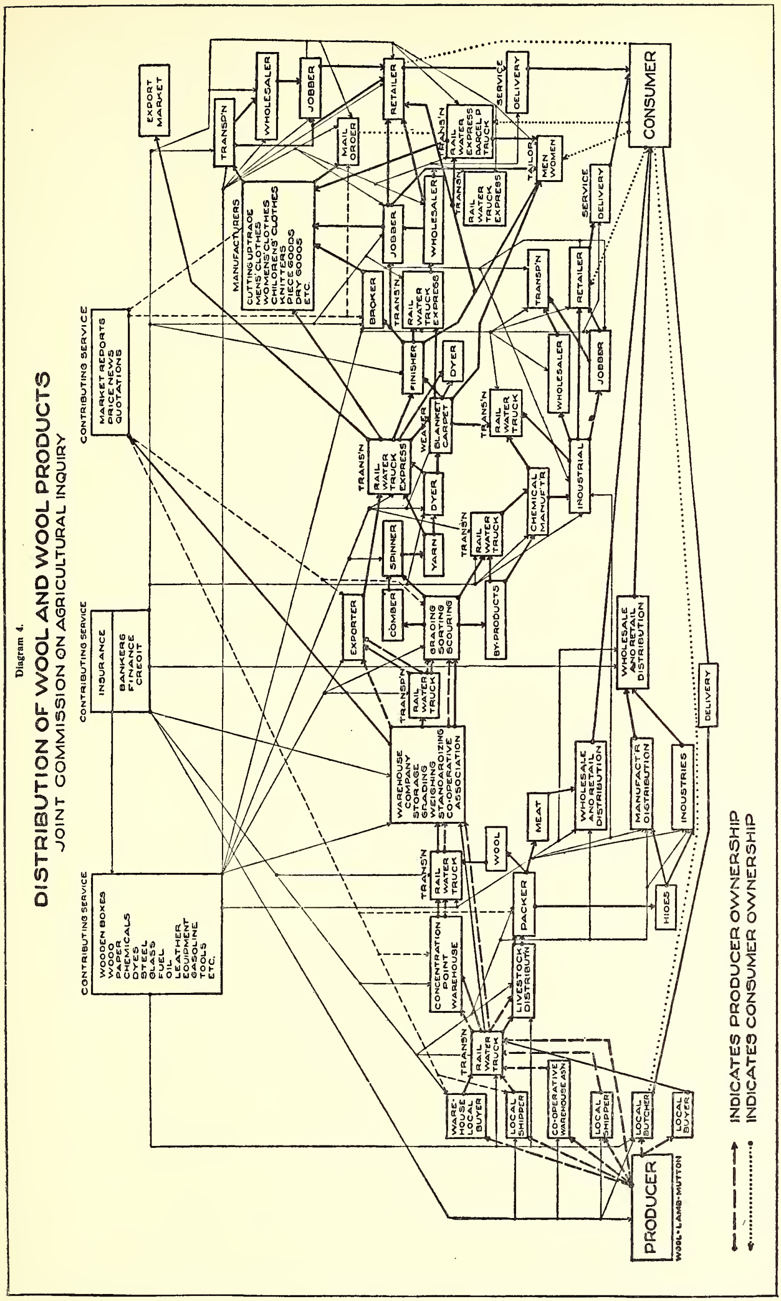

CONTRIBUTING SERVICE
WOODEN BOXES
WOOD
PAPER
CHEMICALS
DYES
STEEL
GLASS
FUEL
OIL
LEATHER
EQUIPMENT
GASOLINE
TOOLS
ETC.
CONTRIBUTING SERVICE
INSURANCE
BANKERS
FINANCE
CREDIT
CONTRIBUTING SERVICE
MARKET REPORTS
PRICE NEWS
QUOTATIONS
EXPORT MARKET
PRODUCER
WOOL-LAMB-MUTTON
WARE-HOUSE
LOCAL BUYER
LOCAL SHIPPER
CO-OPERATIVE WAREHOUSE ASN
LOCAL SHIPPER
LOCAL BUTCHER
LOCAL BUYER
TRANS'N
RAIL
WATER
TRUCK
CONCENTRATION POINT WAREHOUSE
LIVESTOCK DISTRIBUT'N
PACKER
HIDES
TRANS'N
RAIL
WATER
TRUCK
WOOL
MEAT
WHOLESALE AND RETAIL DISTRIBUTION
MANUFACT'R DISTRIBUTION
INDUSTRIES
DELIVERY
WAREHOUSE
COMPANY
STORAGE
GRADING
WEIGHING
STANDARDIZING
CO-OPERATIVE
ASSOCIATION
TRANSP'N
RAIL
WATER
TRUCK
EXPORTER
GRADING
SORTING
SCOURING
COMBER
BY-PRODUCTS
WHOLESALE AND RETAIL DISTRIBUTION
SPINNER
YARN
TRANS'N
RAIL
WATER
TRUCK
CHEMICAL MANUF'TR
INDUSTRIAL
DYER
TRANS'N
RAIL
WATER
TRUCK
EXPRESS
WEAVER
BLANKET
CARPET
TRANS'N
RAIL
WATER
TRUCK
WHOLESALER
JOBBER
FINISHER
DYER
BROKER
TRANS'N
RAIL
WATER
TRUCK
EXPRESS
TRANSP'N
RETAILER
SERVICE
DELIVERY
MANUFACTURERS
CUTTING UP TRADE
MENS' CLOTHES
WOMENS' CLOTHES
CHILDRENS' CLOTHES
KNITTERS
PIECE GOODS
DRY GOODS
ETC.
JOBBER
WHOLESALER
TRANS'N
RAIL
WATER
TRUCK
EXPRESS
TAILOR
MEN
WOMEN
TRANSP'N
WHOLESALER
JOBBER
MAIL ORDER
RETAILER
TRANS'N
RAIL
WATER
EXPRESS
PARCEL P
TRUCK
SERVICE
DELIVERY
CONSUMER
INDICATES PRODUCER OWNERSHIP
INDICATES CONSUMER OWNERSHIP

Diagram 5

DISTRIBUTION OF COTTON AND COTTON PRODUCTS

JOINT COMMISSION OF AGRICULTURAL INQUIRY

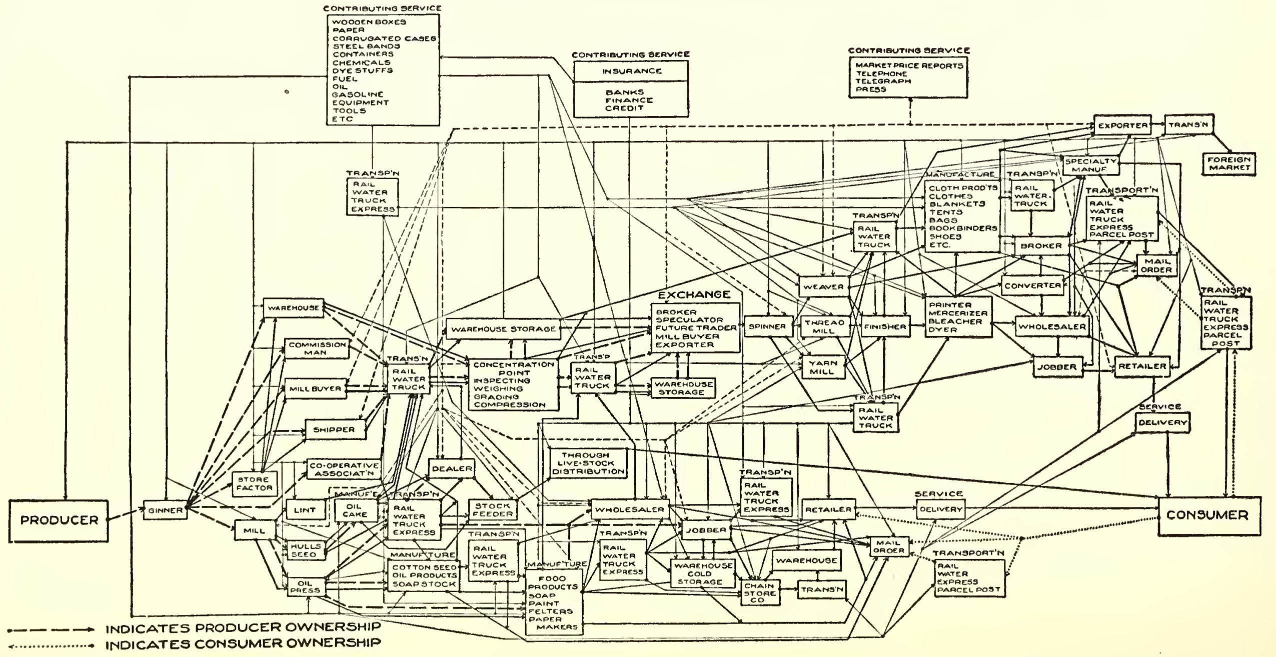

CONTRIBUTING SERVICE
WOODEN BOXES
PAPER
CORRUGATED CASES
STEEL BANDS
CONTAINERS
CHEMICALS
DYE STUFFS
FUEL
OIL
GASOLINE
EQUIPMENT
TOOLS
ETC
CONTRIBUTING SERVICE
INSURANCE
BANKS
FINANCE
CREDIT
CONTRIBUTING SERVICE
MARKET PRICE REPORTS
TELEPHONE
TELEGRAPH
PRESS
EXPORTER
TRANS'N
FOREIGN MARKET
TRANSP'N
RAIL
WATER
TRUCK
EXPRESS
SPECIALTY MANUF
MANUFACTURE
CLOTH PROD'TS
CLOTHES
BLANKETS
TENTS
BAGS
BOOKBINDERS
SHOES
ETC.
TRANSP'N
RAIL
WATER
TRUCK
TRANSPORT'N
RAIL
WATER
TRUCK
EXPRESS
PARCEL POST
TRANSP'N
RAIL
WATER
TRUCK
BROKER
MAIL ORDER
WEAVER
CONVERTER
TRANSP'N
RAIL
WATER
TRUCK
EXPRESS
PARCEL
POST
EXCHANGE
BROKER
SPECULATOR
FUTURE TRADER
MILL BUYER
EXPORTER
SPINNER
THREAD MILL
FINISHER
PRINTER
MERCERIZER
BLEACHER
DYER
WHOLESALER
WAREHOUSE
WAREHOUSE STORAGE
COMMISSION MAN
TRANS'N
RAIL
WATER
TRUCK
CONCENTRATION POINT
INSPECTING
WEIGHING
GRADING
COMPRESSION
TRANS'P
RAIL
WATER
TRUCK
WAREHOUSE STORAGE
YARN MILL
JOBBER
RETAILER
MILL BUYER
SHIPPER
TRANSP'N
RAIL
WATER
TRUCK
SERVICE
DELIVERY
THROUGH LIVE-STOCK DISTRIBUTION
CO-OPERATIVE ASSOCIAT'N
DEALER
STORE FACTOR
PRODUCER
GINNER
LINT
MANUF'E
OIL CAKE
TRANSP'N
RAIL
WATER
TRUCK
EXPRESS
STOCK FEEDER
WHOLESALER
TRANSP'N
RAIL
WATER
TRUCK
EXPRESS
RETAILER
SERVICE
DELIVERY
CONSUMER
MILL
HULLS SEED
JOBBER
MAIL ORDER
TRANSP'N
RAIL
WATER
TRUCK
EXPRESS
TRANSP'N
RAIL
WATER
TRUCK
EXPRESS
MANUF'TURE
COTTON SEED
OIL PRODUCTS
SOAP STOCK
MANUF'TURE
FOOD PRODUCTS
SOAP
PAINT
FELTERS
PAPER
MAKERS
WAREHOUSE COLD STORAGE
WAREHOUSE
TRANSPORT'N
RAIL
WATER
EXPRESS
PARCEL POST
OIL PRESS
CHAIN STORE CO
TRANS'N
INDICATES PRODUCER OWNERSHIP
INDICATES CONSUMER OWNERSHIP

Diagram 6.

DISTRIBUTION OF DAIRY PRODUCTS
JOINT COMMISSION OF AGRICULTURAL INQUIRY

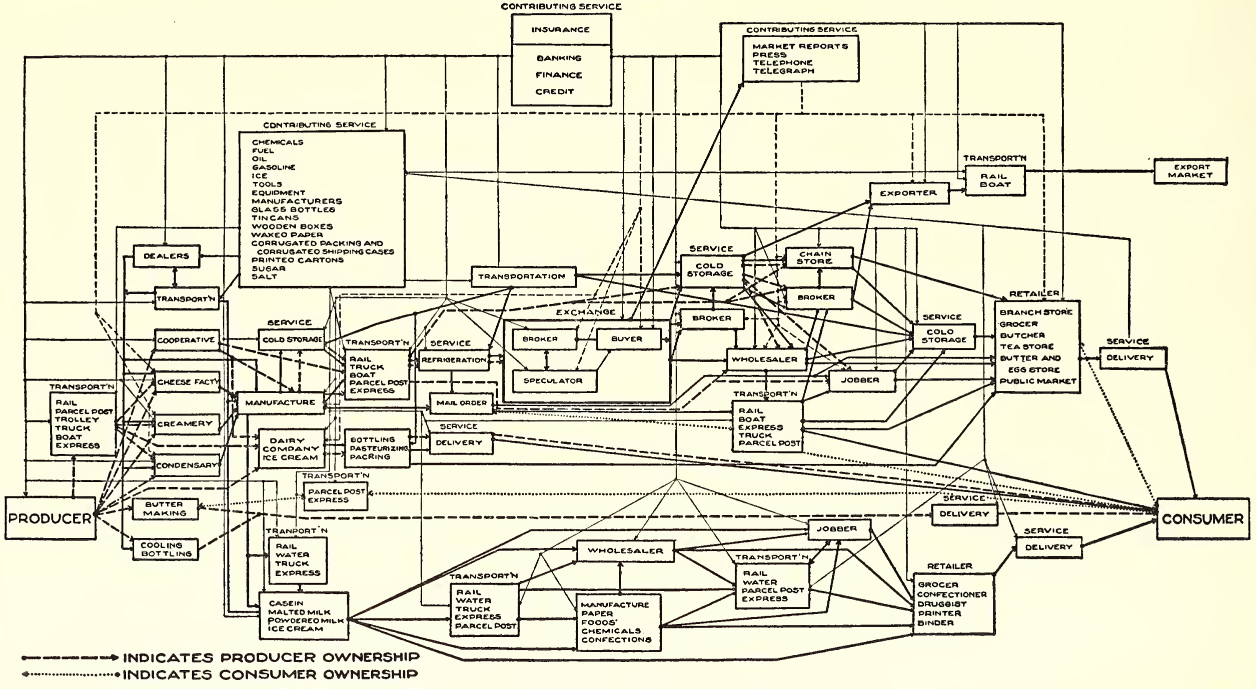
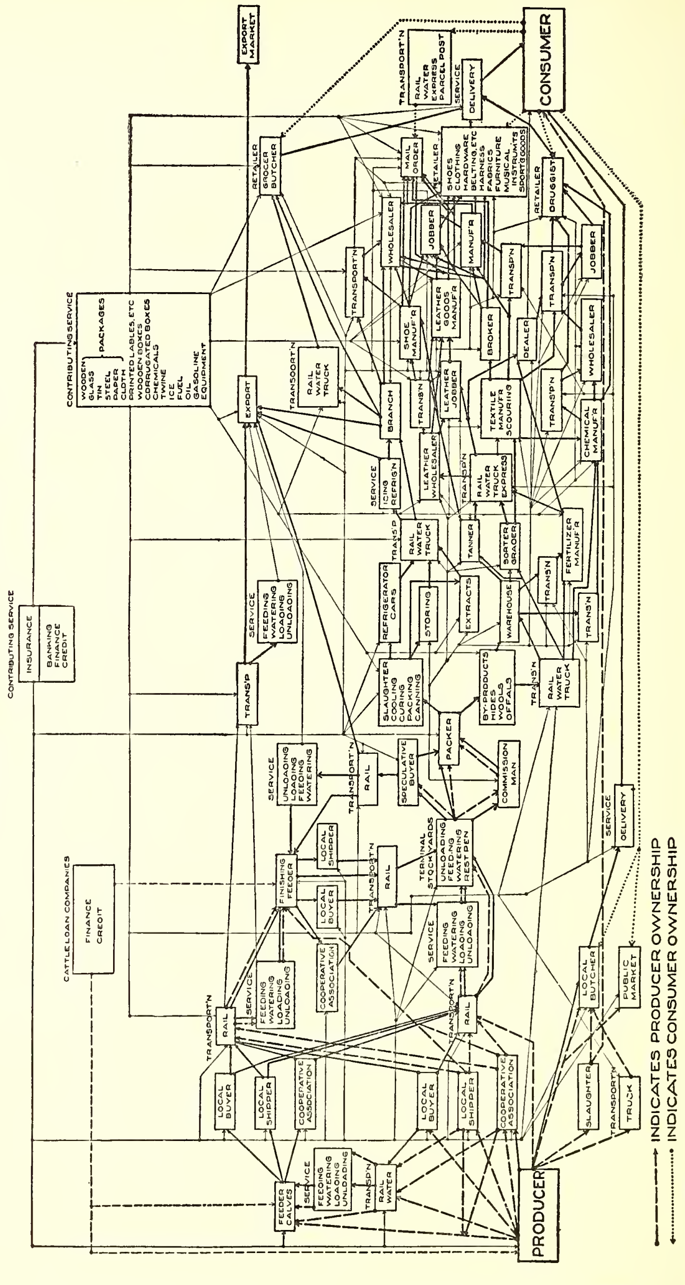

CONTRIBUTING SERVICE
INSURANCE
BANKING
FINANCE
CREDIT
CONTRIBUTING SERVICE
MARKET REPORTS
PRESS
TELEPHONE
TELEGRAPH
CONTRIBUTING SERVICE
CHEMICALS
FUEL
OIL
GASOLINE
ICE
TOOLS
EQUIPMENT
MANUFACTURERS
GLASS BOTTLES
TIN CANS
WOODEN BOXES
WAXED PAPER
CORRUGATED PACKING AND CORRUGATED SHIPPING CASES
PRINTED CARTONS
SUGAR
SALT
TRANSPORT'N
RAIL
BOAT
EXPORT MARKET
EXPORTER
DEALERS
TRANSPORT'N
TRANSPORTATION
SERVICE
COLD STORAGE
CHAIN STORE
BROKER
RETAILER
BRANCH STORE
GROCER
BUTCHER
TEA STORE
BUTTER AND EGG STORE
PUBLIC MARKET
SERVICE
DELIVERY
EXCHANGE
BROKER
BUYER
SPECULATOR
BROKER
WHOLESALER
SERVICE
COLD STORAGE
JOBBER
COOPERATIVE
SERVICE
COLD STORAGE
TRANSPORT'N
RAIL
TRUCK
BOAT
PARCEL POST
EXPRESS
SERVICE
REFRIGERATION
TRANSPORT'N
RAIL
PARCEL POST
TROLLEY
TRUCK
BOAT
EXPRESS
CHEESE FACT'Y
MANUFACTURE
MAIL ORDER
CREAMERY
DAIRY COMPANY ICE CREAM
BOTTLING
PASTEURIZING
PACKING
SERVICE
DELIVERY
TRANSPORT'N
RAIL
BOAT
EXPRESS
TRUCK
PARCEL POST
CONDENSARY
TRANSPORT'N
PARCEL POST
EXPRESS
PRODUCER
BUTTER MAKING
SERVICE
DELIVERY
CONSUMER
COOLING BOTTLING
JOBBER
SERVICE
DELIVERY
TRANPORT'N
RAIL
WATER
TRUCK
EXPRESS
WHOLESALER
TRANSPORT'N
RAIL
WATER
PARCEL POST
EXPRESS
RETAILER
GROCER
CONFECTIONER
DRUGGIST
PRINTER
BINDER
TRANSPORT'N
RAIL
WATER
TRUCK
EXPRESS
PARCEL POST
MANUFACTURE
PAPER
FOODS'
CHEMICALS
CONFECTIONS
CASEIN
MALTED MILK
POWDERED MILK
ICE CREAM
INDICATES PRODUCER OWNERSHIP
INDICATES CONSUMER OWNERSHIP

Diagram 7.

DISTRIBUTION OF LIVE STOCK AND LIVE STOCK PRODUCTS

JOINT COMMISSION ON AGRICULTURAL INQUIRY


CATTLE LOAN COMPANIES
FINANCE CREDIT
CONTRIBUTING SERVICE
INSURANCE
BANKING FINANCE CREDIT
CONTRIBUTING SERVICE
WOODEN GLASS TIN STEEL PAPER CLOTH PACKAGES
PRINTED LABLES, ETC
WOODEN BOXES
CORRUGATED BOXES
CHEMICALS
TWINE
ICE
FUEL
OIL
GASOLINE
EQUIPMENT
EXPORT MARKET
PRODUCER
FEEDER CALVES
SERVICE FEEDING WATERING LOADING UNLOADING
TRANSP'N RAIL WATER
LOCAL BUYER
LOCAL SHIPPER
COOPERATIVE ASSOCIATION
LOCAL BUYER
LOCAL SHIPPER
COOPERATIVE ASSOCIATION
TRANSPORT'N RAIL
SERVICE FEEDING WATERING LOADING UNLOADING
TRANSPORT'N RAIL
FINISHING FEEDER
COOPERATIVE ASSOCIATION
LOCAL BUYER
LOCAL SHIPPER
TRANSPORT'N RAIL
SERVICE FEEDING WATERING LOADING UNLOADING
TERMINAL STOCK YARDS UNLOADING FEEDING WATERING REST PEN
SERVICE UNLOADING LOADING FEEDING WATERING
TRANSPORT'N RAIL
SPECULATIVE BUYER
COMMISSION MAN
PACKER
TRANS'P
SERVICE FEEDING WATERING LOADING UNLOADING
SLAUGHTER COOLING CURING PACKING CANNING
BY-PRODUCTS HIDES WOOLS OFFALS
REFRIGERATOR CARS
STORING
EXTRACTS
WAREHOUSE
TRANS'N RAIL WATER TRUCK
TRANS'N
TRANS'N
TRANS'P RAIL WATER TRUCK
TANNER
SORTER GRADER
FERTILIZER MANUF'R
SERVICE ICING REFRIG'N
EXPORT
TRANSOORT'N RAIL WATER TRUCK
BRANCH
LEATHER WHOLESALER
TRANS'N RAIL WATER TRUCK EXPRESS
TRANS'N
LEATHER JOBBER
TEXTILE MANUF'R SCOURING
TRANS'P'N
CHEMICAL MANUF'R
SHOE MANUF'R
LEATHER GOODS MANUF'R
BROKER
DEALER
WHOLESALER
TRANSPORT'N
WHOLESALER
JOBBER
MANUF'R
TRANSP'N
TRANSP'N
JOBBER
RETAILER GROCER BUTCHER
MAIL ORDER
RETAILER SHOES CLOTHING HARDWARE BELTING, ETC HARNESS FABRICS FURNITURE MUSICAL INSTRUMENTS SPORT'G GOODS
RETAILER DRUGGIST
TRANSPORT'N RAIL WATER EXPRESS PARCEL POST
SERVICE DELIVERY
CONSUMER
SERVICE DELIVERY
LOCAL BUTCHER
PUBLIC MARKET
SLAUGHTER
TRANSPORT'N TRUCK
INDICATES PRODUCER OWNERSHIP
INDICATES CONSUMER OWNERSHIP

APPENDIX B

CLASSIFICATIONS OF RETAIL STORES

Present-day retailing is carried on through a great variety of retail stores which may be classified in various ways. The following classifications are helpful:[1]

I. According to Merchandise Carried

- a. Single-line stores
  - 1. Groceries
  - 2. Meats
  - 3. Hardware
  - 4. Drugs
  - 5. Dry goods
  - 6. Clothing
  - Etc., etc.
- b. Specialty shops—really single-line stores carrying special merchandise catering to limited groups of customers such as—
  - 1. Women's apparel
  - 2. Millinery
  - 3. Shoes
  - Etc., etc.
- c. Multiple-line stores—retail single-line stores branching out and handling several lines of goods, such as—
  - 1. Food markets carrying all types of foods including groceries, meats, dairy products, fish, fruits and vegetables, etc.
  - 2. Apparel for men, women and children.
  - 3. Home furnishings including all classes of goods for furnishing homes.
  - 4. Drug stores having cigar stands, luncheonettes, departments, etc.
- d. Department stores carrying many lines of merchandise. This class of store usually carries dry goods, small wares, apparel for women and children and sometimes

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[1] P. H. Nystrom, *Economics of Retailing,* Vol. II, pp. 3-5.

for men and boys, and home furnishings. A few department stores in this country also have food departments but most do not.

II. According to Services Rendered

a. Automatic retailing—slot machine distribution.
b. Self-service stores—customer makes own selections, pays cash, and carries goods home.
c. Cash and carry stores—includes sales service, aid in selection, etc.
d. Limited service stores—limited charge account privileges or limited deliveries.
e. Full service stores—includes delivery and charge account privileges.
f. Drive-in markets—stores adapted to serve passing motorists without need of getting out of car.
g. Rolling stores—house-to-house selling from motor trucks —a modern form of peddling.
h. Canvassing—house-to-house selling followed by later deliveries.
i. Telephone selling—order taking by telephone and followed by deliveries. Customers of this service need not leave homes to shop for goods.
j. Mail-order houses

III. According to Ownership and Control

a. Independently owned stores—
  1. Individual owner
  2. Partnership
  3. Corporation

b. Branch stores allied to other business interests
  1. Industrial stores, serving employees of an industrial or other organization.
  2. Branch retail store serving as retail outlet or experimental ground for—
    —manufacturer
    —wholesaler
    —mail-order house

c. Chain or multiple-owned stores—two or more stores under same ownership.

d. Independently owned stores. Sometimes called "voluntary chains," united by—
  1. Contracts to buy certain goods and perform certain services fixed by a central organization such as a wholesaler, manufacturer, or cooperative group of

    retailers, such as Independent Grocers Alliance and Frankford Grocery Company
  2. Licenses to use certain systems of merchandising such as Piggly Wiggly

e. Consumers' cooperative stores.

IV. ACCORDING TO LOCATION

a. Country crossroads stores serving rural trade.
b. Village stores serving both country and village trade.
c. Marketing center stores drawing trade from a wide radius.
d. Metropolitan shopping center stores.
e. Suburban marketing and shopping centers.
f. Neighborhood stores.
g. Roadside stands.

APPENDIX C

SOURCES OF RESEARCH INFORMATION

The following outline shows the major sources of research information, and the type of work undertaken by each agency.[1]

I. The United States Government

An organization chart of the Government of the United States shows three branches—Legislative, Executive, Judicial. The first two of these gather and publish a large amount of market information.

A—The Legislative Branch

The Legislative Branch is a source of research information through:

1. Congressional Committees
2. Special Commissions appointed for specific studies
3. House and Senate Documents

1. Congressional Committees which have under their jurisdiction matters which have a bearing direct or indirect upon commerce, are:

House of Representatives

Agriculture
Appropriations
Banking and Currency
Census
Coinage, Weights and Measures
Industrial Arts and Expositions
Insular Affairs
Interstate and Foreign Commerce
Irrigation and Reclamation
Labor
Mines and Mining
Patents
Public Lands
Rivers and Harbors
Roads
Ways and Means

Senate

Agriculture and Forestry
Banking and Currency
Commerce
Education and Labor
Finance
Interstate Commerce
Irrigation and Reclamation
Manufacture
Mines and Mining
Patents
Public Lands and Surveys
Territories and Insular Possessions

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[1] This outline is adapted from the report of the National Distribution Conference held in Washington, D. C., in 1925.

These committees make investigations and hold hearings, in the course of which valuable information is sometimes introduced. It is available in the forms of House and Senate Documents, which are described later herein.

2. Special Commissions are appointed for various purposes, usually to examine some situation in greater detail than is possible in the ordinary deliberations of Congress. An example of such a commission is the Joint Commission of Agricultural Inquiry, which made an exhaustive study of certain subjects designated by Congress and rendered a detailed and voluminous report.

3. House and Senate Documents are printed on a great variety of subjects. They are numbered; and are indexed by subjects only in the regular Congressional Directory Index. It is probable that very little original data is included in these documents, which would have a bearing on market analysis.

B—The Executive Branch

As the departments of the government headed by cabinet officers as well as the independent establishments are under the Executive Branch, this is the most prolific source of information.

The executive departments of the government whose work includes considerable market research are:

Department of the Treasury
- Bureau of Internal Revenue
  - Annual Report of Commissioner
    - Statistics on receipts from internal revenue taxes, manufacture of tobacco, cigars, cigarettes, oleomargarine, renovated butter, mixed flour, narcotic drugs, distilled spirits, alcohol, liquids and cereal beverages, brandy, champagne, wine; miscellaneous statistics.
  - Statistics of Income
    - Compiled by Statistical Division, Income Tax Unit.

Department of State
- Consular Reports

Department of Agriculture
1. Weather Bureau
   - Statistics through:
     - Forest Service—weather
     - Climatological Service—climate

2. Bureau of Animal Industry
   - Annual report of Chief of Bureau
   - Monthly publication, "Service and Regulatory Announcements," contains some statistics of general interest and value.
   - Special bulletins of studies: "Farmers' Bulletins"

3. Bureau of Plant Industry
   - "Preliminary Estimates of Crop Losses"

4. Federal Horticultural Board
   - Annual report contains some figures on importations.

5. Forest Service
   - Annual bulletin "Production of Lumber, Lath and Shingles," based on reports of about 30,000 mills, secured through cooperation of National Lumber Manufacturers' Association.
   - Annual bulletin "Pulpwood Consumption and Wood Pulp Production."
   - Annual report of Forester.

6. Bureau of Chemistry
   - Monthly Review of the Bureau of Chemistry contains information on production and stocks of naval stores and information on products analyzed under Food and Drug Acts.

7. Bureau of Biological Survey
   - Annual report and occasional bulletins include fur shipments from Alaska.

8. Bureau of Public Roads
   - Monthly publication, "Public Roads," shows autos, trucks and commercial vehicles, motorcycles; registrations; licenses to owners, chauffeurs, manufacturers and dealers.
   - Also special bulletins

9. Bureau of Agricultural Economics
   - Division of Information issues "Weather, Crops and Markets"; miscellaneous bulletins; has all statistical material collected by Department of Agriculture since 1839. Other divisions doing research work are:
     - Farm Management and Cost of Production
     - Land Economics and Land Utilization

- Agricultural Finance
- Farm Population and Rural Life
- Livestock, Meats, and Wool
- Dairy and Poultry Products
- Fruits and Vegetables
- Cotton Marketing
- Grain
- Hay, Feed, and Seed
- Crop Estimates
- Statistical and Historical Research
- Cost of Marketing Farm Products
- Agricultural Cooperation
- Warehousing
- City Markets

Much of the Bureau's work appears in recapitulation in the Agricultural Year Book of the Department of Agriculture. The most important market publications of the Bureau are:

- "Foreign Crops and Markets"—weekly
- "State and Federal Marketing Activities"—weekly
- "Crops and Markets"—weekly

10. Special studies

The Fixed Nitrogen Research Laboratory; Packers and Stockyards Administration and Grain Futures Administration are under the Secretary of Agriculture. The last two are regulatory bodies.

DEPARTMENT OF COMMERCE

1. Bureau of the Census

Collects statistics on:

- Births and deaths
- Finances of cities
- Finances of states
- Manufacturers (356 classifications)
- Electrical industries
- Fisheries
- Wealth, debt, taxation
- Prisoners
- Insane
- Paupers
- Population
- Occupations
- Agriculture
- Mines and Quarries
- Water Transportation
- Religious bodies
- Cotton
- Tobacco
- Fats and oils
- Wool machinery
- Hides and skins

Reports on these vary from monthly to decennially.

2. Bureau of Foreign and Domestic Commerce
   - Commodity Divisions
     - Agricultural Implements
     - Automotive
     - Chemical
     - Coal
     - Electrical Equipment
     - Foodstuffs
     - Hides and Leather
     - Machinery
     - Iron and Steel
     - Lumber
     - Nitrogen
     - Paper
     - Petroleum
     - Rubber
     - Shoe and Leather mfrs.
     - Sisal
     - Specialties
     - Textile
     - Transportation and Communication
     - Minerals
   - Technical Divisions
     - Foreign Tariffs
     - Commercial Laws
     - Finance and Investment
     - Statistical Research
     - Statistics
     - Commercial Intelligence
   - Bureau of Customs Statistics (New York)
     - Export and Import Statistics
   - Domestic Commerce Division
     - Studies domestic trade
   - Some Publications of Foreign and Domestic Commerce:
     - Monthly Summary of Foreign Commerce of United States
     - Foreign Commerce and Navigation of the United States (annual)
     - Trade of the United States with the World (biennial) (Advance sheets in multigraphed form—monthly)
     - Statistical Abstracts of the United States
     - Commercial Yearbook
     - Survey of Current Business (monthly)
     - Commerce Reports (weekly)
     - Index to Commerce Reports (quarterly)
     - Report of Director of Bureau of Foreign and Domestic Commerce (annual)
     - Report of trade commissioners on specific studies
     - List of Publications of the Department of Commerce
3. Bureau of Fisheries
   - Fish and fishery products information
   - Market surveys
4. Bureau of Navigation
   - Shipping statistics—Annual Report of Commissioner of Navigation

5. Bureau of Standards
    - Supplies some statistics for Survey of Current Business
    - Division of Simplified Practice
    - Studies duplications in manufacture and the elimination of waste possible through reducing the number of varieties.

DEPARTMENT OF LABOR

1. Bureau of Labor Statistics
    - Wholesale and retail prices
    - Labor hours and wages
    - Reports received annually from about 90% of iron and steel manufacturers of the United States
    - Publishes Monthly Labor Review
    - Miscellaneous bulletins
2. Bureau of Immigration
    - Annual Report of the Commissioner General of Immigration
3. U. S. Employment Service
    - Industrial Employment Information Bulletin (monthly)
    - Annual Report of Director General
4. Bureau of Industrial Housing and Transportation
    - (No publications)

Independent Establishments of the United States Government

INTERSTATE COMMERCE COMMISSION

UNITED STATES TARIFF COMMISSION

Original research on production, price data, competitive conditions, etc.

FEDERAL RESERVE BOARD

Publishes statistics on conditions of banks, stocks of money, foreign exchange, general trade statistics, wholesale price index abroad and in the United States, international price index, indices of retail prices and cost of living, miscellaneous foreign statistics, physical volumes of trade, specific commodity statistics.

Publication is the Federal Reserve Bulletin (monthly).

Federal Reserve agent in each district issues a monthly review of credit and business conditions in his district.

FEDERAL TRADE COMMISSION

Special economic investigations, such as that on house-furnishings industries, usually in bulletin form; also studies of current conditions of production, stocks, prices, costs, etc. Federal Trade

Commission decisions give legal and economic arguments on both sides of questions being tried before the Commission.

A few periodical bulletins as the Paper Trade Bulletins, Bituminous Coal Bulletins, etc.

II. State and Municipal Governments

States

Many of the state governments do research work of various types. Much of it is done in conjunction or cooperation with the federal government. Examples of this are the crop estimates of the Department of Agriculture and the extension work of the Bureau of Home Economics. Some state government departments collecting and distributing statistics are:

Massachusetts Department of Labor and Industries
Massachusetts Department of Public Utilities
New York State Department of Labor
New York State Department of Public Works
Pennsylvania Department of Labor and Industry
Wisconsin Industrial Commission

The State of Pennsylvania, through its Bureau of Statistics and Information of Internal Affairs, has compiled a fairly accurate record of the mercantile business of the State. This record is not the result of intentional research investigations; but it is the result of returns from the state tax law which requires all wholesale and retail establishments to make a return on the amount of business done. This suggests a means for obtaining data which may have been collected already but which has not been collated for practical application to market analysis. Its publication has been discontinued, at least, temporarily. Apparently there is no index or guide to such work of other states.

Municipalities

The administration of municipal governments requires the collection of a certain amount of statistical information. Chambers of Commerce have also made some commercial and industrial studies in their respective cities. Municipal investigations by newspapers will be mentioned later on. In compiling any guide or index to such municipal studies it is necessary to consider the work of organizations such as the "Bureau of Municipal Research and Training School for Public Service." The publication of this organization is the monthly "Municipal Research." No guide to municipal research has been compiled as far as quick examination could discover.

III. Foreign Governments

All of the important governments of the world have compilations of trade statistics, many of which are superior to those available in the United States. These services will not be discussed here, however. Attention is merely called, in passing, to the unusually valuable researches of the Economic Section of the League of Nations at Geneva, and of the International Institute of Agriculture at Rome.

IV. Private Agencies

(a) Publications

The analysis of the New York City market by the New York *World* (e.g., "Merchandising America's Greatest Retail Market") and various studies of the same market by the New York *American* are typical of the research work done in this field by metropolitan newspapers.

Trade publications are also engaged in the work of analyzing markets and a comparison of the researches made by them should reveal any duplications and also the possibilities for pooling efforts and results, where the information collected is non-confidential.

"Dun's" and "Bradstreet's" give data on business concerns which may be of use in market analysis. Commercial and trade directories are also in this class.

(b) Endowed Foundations

Some of the best known of the endowed foundations are mentioned here. Most of these are scientific in nature rather than commercial.

1. National Research Council

Established in 1916 at the request of the President of the United States under the charter of the National Academy of Sciences. Converted from a war-time organization to a peace-time organization. Has a Division of Federal Relations which includes representatives of various government scientific departments, bureaus, and organizations. Its work is mostly of a purely scientific character. It cooperates closely with the Engineering Foundation, mentioned below. Its major support is derived from the Carnegie Corporation.

The council is composed of a series of major divisions, one group of seven divisions of science and technology representing, respectively, physics, mathematics and astronomy; chemistry and chemical technology; psychology and anthropology; geology and geography; biology and agriculture; the medical sciences; and engineering; and another group of six divisions of general relations, representing foreign relations, federal relations, states relations, educational relations, research extension, and research information. As subordinate or affiliated lesser groups, each of these divisions comprises a larger or smaller series of committees, each with its special problems or subject of attention. There are certain other committees, administrative and technical, which affiliate directly with the executive board of the council.

2. ENGINEERING FOUNDATION

Established in 1914 by the American Societies of Civil, Mining, Mechanical and Electrical Engineers "for the furtherance of research in science and engineering." Some of its specific functions are:

Organizing, administering, and aiding cooperative researches and investigations.
Making results of research and investigation available to engineers and industry.
Supporting selected researches and investigations, particularly those expected to yield information of general benefit, but of such nature as not likely to be undertaken by an industrial, a governmental or a private laboratory, separately, with its own resources.
Furthering interest in scientific and technical research.

Publications are reports, reprints from periodicals, research narratives.

3. RUSSELL SAGE FOUNDATION

Has a Department of Statistics which prepares statistical reports on social conditions—filed in library of Foundation in New York.

4. CARNEGIE INSTITUTE

Includes:

Institute of Economics, Washington.
National Bureau of Economic Research, Inc., New York. Studies of income in the United States, nationally and by states. History of the development of trade unions in the United States.

Institute for Research in Land Economics and Public Utilities, Chicago, Ill.
Food Research Institute carried on in cooperation with trustees of Stanford University.

5. National Industrial Conference Board

The National Industrial Conference Board is a cooperative body composed of representatives of national and state industrial associations and is organized to provide a clearing house of information, a forum for constructive discussion, and machinery for cooperative action on matters that vitally affect the industrial development of the nation. Publications are: Research Reports, Special Reports, and the "Industrial News Survey."

(c) Economic Services

A partial list of these services follows:

Harvard Economic Service, Cambridge, Mass.
Standard Statistics Co., Inc., New York City
Babson's Institute, Wellesley Hills, Mass.
Brookmire Economic Service, Inc., New York City
The Richie Data Service, Indianapolis, Ind.
Bankers' Information Service, Washington, D. C.
Commercial Digest, New York City
Federal Trade Information Service, Washington, D. C.

(d) Associations

Most trade associations collect some statistics. An extensive list of associations supplying statistics to the U. S. Government is printed in the Survey of Current Business. So far as can be discovered there is no index or other guide to all association research work being done. Some associations, such as the Bureau of Railway Economics, maintain large libraries and compile extensive bibliographies and other sources of information.

Association statistics are classified by the Department of Commerce as follows:

- Current Statistics
  - Production during period reported
  - Employment conditions
  - Shipment during period reported (tonnage) physical quantity
  - Orders or sales
  - Stocks on hand at end of period reported
  - Cancellations—orders or contracts
  - Price quotations
- Special Statistics

- Non-current Statistics
  - Productive capacities
  - Employment capacities
  - Costs
  - Market studies

(e) Bureaus of Business Research

These have been established in connection with several of the large Universities. The publications of the Harvard, Northwestern, Michigan, Ohio, and Denver Bureaus are especially noteworthy.

The above classification is by no means complete. It points out, however, that market research is rapidly developing as an adjunct to the scientific approach to marketing problems. The research undertaken by public and quasi-public organizations is available to all interested parties. As these studies accumulate, and as the technique of market forecasting is developed, much of the uncertainty of business will be removed.

(f) Quarterlies and Magazines

There are a number of quarterlies and magazines which report current researches. Such publications also include articles descriptive of business practices, and discussions of theoretic import. The following list is by no means complete, but it includes typical examples.

American Economic Review
American Statistical Journal
Journal of Farm Economics
Journal of Political Economy
Quarterly Journal of Economics

Harvard Business Review
Journal of Business

Advertising and Selling
Class and Industrial Marketing
Management and Administration
Nation's Business
Printer's Ink (Weekly and Monthly)
Retailing
Retail Ledger
Salesmanagement
Women's Wear

APPENDIX D

AGRICULTURAL MARKETING ACT

(PUBLIC—NO. 10—71ST CONGRESS)
(H. R. 1)

An Act To establish a Federal Farm Board to promote the effective merchandising of agricultural commodities in interstate and foreign commerce, and to place agriculture on a basis of economic equality with other industries.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled.

DECLARATION OF POLICY

Section 1. (a) That it is hereby declared to be the policy of Congress to promote the effective merchandising of agricultural commodities in interstate and foreign commerce, so that the industry of agriculture will be placed on a basis of economic equality with other industries, and to that end to protect, control, and stabilize the currents of interstate and foreign commerce in the marketing of agricultural commodities and their food products—

(1) by minimizing speculation.

(2) by preventing inefficient and wasteful methods of distribution.

(3) by encouraging the organization of producers into effective associations or corporations under their own control for greater unity of effort in marketing and by promoting the establishment and financing of a farm marketing system of producer-owned and producer-controlled co-operative associations and other agencies.

(4) by aiding in preventing and controlling surpluses in any agricultural commodity, through orderly production and distribution, so as to maintain advantageous domestic markets and prevent such surpluses from causing undue and excessive fluctuations or depressions in prices for the commodity.

(b) There shall be considered as a surplus for the purposes of this Act any seasonal or year's total surplus, produced in the United States and either local or national in extent, that is in excess of the requirements for the orderly distribution of the agricultural commodity or is in excess of the domestic requirements for such commodity.

(c) The Federal Farm Board shall execute the powers vested in it by this Act only in such manner as will, in the judgment of the board, aid to the fullest practicable extent in carrying out the policy above declared.

Federal Farm Board

Sec. 2. A Federal Farm Board is hereby created, which shall consist of eight members to be appointed by the President, by and with the advice and consent of the Senate, and of the Secretary of Agriculture, ex officio. In making the appointments the President shall give due consideration to having the major agricultural commodities produced in the United States fairly represented upon the board. The terms of office of the appointed members of the board first taking office after the date of the approval of this Act shall expire, as designated by the President at the time of nomination, two at the end of the first year, two at the end of the second year, one at the end of the third year, one at the end of the fourth year, one at the end of the fifth year, and one at the end of the sixth year after such date.

A successor to an appointed member of the board shall have a term of office expiring six years from the date of the expiration of the term for which his predecessor was appointed, except that any person appointed to fill a vacancy in the board occurring prior to the expiration of the term for which his predecessor was appointed, shall be appointed for the remainder of such term. One of the appointed members shall be designated by the President as chairman of the board and shall be the principal executive officer thereof. The board shall select a vice chairman who shall act as chairman in case of the absence or disability of the chairman. The board may function notwithstanding vacancies, and a majority of the appointed members in office shall constitute a quorum. Each appointed member shall be a citizen of the United States and shall not actively engage in any other business, vocation, or employment than that of serving as a member of the board; nor shall any appointed member during his term of office engage in the business (except such business as is necessary to the operation of his own farm or farms) of buying and selling, or otherwise be financially interested in, any agricultural commodity or product thereof. Each appointed member shall receive a salary of $12,000 a year, together with necessary traveling and subsistence expenses, or per diem allowance in lieu thereof, within the limitations prescribed by law, while away from his official station upon official business.

ADVISORY COMMODITY COMMITTEES

Sec. 3. (a) The Board is authorized to designate, from time to time, as an agricultural commodity for the purposes of this Act (1) any regional or market classification or type of any agricultural commodity which is so different in use or marketing methods from other such classifications or types of the commodity as to require, in the judgment of the board, treatment as a separate commodity under this Act; or (2) any two or more agricultural commodities which are so closely related in use or marketing methods as to require, in the judgment of the board, joint treatment as a single commodity under this Act.

(b) The board shall invite the co-operative associations handling any agricultural commodity to establish an advisory commodity committee to consist of seven members, of whom at least two shall be experienced handlers or processors of the commodity, to represent such commodity before the board in matters relating to the commodity. Members of each advisory committee shall be selected by the co-operative associations from time to time in such manner as the board shall prescribe. No salary shall be paid to committee members, but the board shall pay each a per diem compensation not exceeding $20 for attending committee meetings called by the board and for time devoted to other business of the committee authorized by the board, and necessary traveling and subsistence expenses, or per diem allowance in lieu thereof, within the limitations prescribed by law for civilian employees in the Executive branch of the Government. Each advisory committee shall be designated by the name of the commodity it represents, as, for example, the "Cotton Advisory Committee."

(c) Each advisory committee shall meet as soon as practicable after its selection, at a time and place designated by the board. Each advisory committee shall meet thereafter at least twice a year upon call of the board, and may meet at other times upon call of a majority of the members thereof. Each advisory committee shall select a chairman and secretary.

(d) Each advisory committee may by itself or through its officers, (1) confer directly with the board, call for information from it, or make oral or written representations to it, concerning matters within the jurisdiction of the board and relating to the agricultural commodity, and (2) co-operate with the board in advising the producers through their organizations or otherwise in the development of suitable programs of planting or breeding in order to secure the maximum benefits under this Act consistent with the policy declared in section 1.

General Powers of Board

Sec. 4. The board—

(1) shall maintain its principal office in the District of Columbia, and such other offices in the United States as in its judgment are necessary.

(2) shall have an official seal which shall be judicially noticed.

(3) shall make an annual report to Congress upon the administration of this Act and any other matter relating to the better effectuation of the policy declared in section 1, including recommendations for legislation.

(4) may make such regulations as are necessary to execute the functions vested in it by this Act.

(5) may appoint and fix the salaries of a secretary and such experts, and, in accordance with the Classification Act of 1923, as amended, and subject to the provisions of the civil service laws, such other officers and employees, as are necessary to execute such functions.

(6) may make such expenditures (including expenditures for rent and personal services at the seat of government and elsewhere, for law books, periodicals, and books of reference, and for printing and binding) as are necessary to execute such functions. Expenditures by the board shall be allowed and paid upon the presentation of itemized vouchers therefor approved by the chairman of the board.

(7) shall meet at the call of the chairman, the Secretary of Agriculture, or a majority of its members.

Special Powers of Board

Sec. 5. The board is authorized and directed—

(1) to promote education in the principles and practices of co-operative marketing of agricultural commodities and food products thereof.

(2) to encourage the organization, improvement in methods, and development of effective co-operative associations.

(3) to keep advised from any available sources and make reports as to crop prices, experiences, prospects, supply, and demand, at home and abroad.

(4) to investigate conditions of overproduction of agricultural commodities and advise as to the prevention of such overproduction.

(5) to make investigations and reports and publish the same, including investigations and reports upon the following: Land utilization for agricultural purposes; reduction of the acreage of unprofitable marginal lands in cultivation; methods of expanding markets at

home and abroad for agricultural commodities and food products thereof; methods of developing by-products of and new uses for agricultural commodities; and transportation conditions and their effect upon the marketing of agricultural commodities.

Revolving Fund

Sec. 6. There is hereby authorized to be appropriated the sum of $500,000,000 which shall be made available by the Congress as soon as practicable after the approval of this Act and shall constitute a revolving fund to be administered by the board as provided in this Act.

Loans to Co-operative Associations

Sec. 7. (a) Upon application by any co-operative association the board is authorized to make loans to it from the revolving fund to assist in—

(1) the effective merchandising of agricultural commodities and food products thereof;

(2) the construction or acquisition by purchase or lease of physical marketing facilities for preparing, handling, storing, processing, or merchandising agricultural commodities or their food products;

(3) the formation of clearing house associations;

(4) extending membership of the co-operative association applying for the loan by educating the producers of the commodity handled by the association in the advantages of co-operative marketing of that commodity; and

(5) enabling the co-operative association applying for the loan to advance to its members a greater share of the market price of the commodity delivered to the association than is practicable under other credit facilities.

(b) No loan shall be made to any co-operative association unless, in the judgment of the board, the loan is in furtherance of the policy declared in section 1 and the co-operative association applying for the loan has an organization and management, and business policies, of such character as to insure the reasonable safety of the loan and the furtherance of such policy.

(c) Loans for the construction or acquisition by purchase or lease of physical facilities shall be subject to the following limitations:

(1) No such loan for the construction or purchase of such facilities shall be made in an amount in excess of 80 per centum of the value of the facilities to be constructed or purchased.

(2) No loan for the purchase or lease of such facilities shall be made unless the board finds that the purchase price or rent to be paid is reasonable.

(3) No loan for the construction, purchase, or lease of such facilities shall be made unless the board finds that there are not available suitable existing facilities that will furnish their services to the co-operative association at reasonable rates; and in addition to the preceding limitation, no loan for the construction of facilities shall be made unless the board finds that suitable existing facilities are not available for purchase or lease at a reasonable price or rent.

(d) Loans for the construction or purchase of physical facilities, together with interest on the loans, shall be repaid upon an amortization plan over a period not in excess of 20 years.

Miscellaneous Loan Provisions

Sec. 8. (a) Loans to any co-operative association or stabilization corporation and advances for insurance purposes shall bear interest at a rate of interest per annum equal to the lowest rate of yield (to the nearest one-eighth of 1 per centum) of any Government obligation bearing a date of issue subsequent to April 6, 1917 (except postal-savings bonds), and outstanding at the time the loan agreement is entered into or the advance is made by the board, as certified by the Secretary of the Treasury to the board upon its request: Provided, That in no case shall the rate exceed 4 per centum per annum on the unpaid principal.

(b) Payments of principal or interest upon any such loan or advance shall be covered into the revolving fund.

(c) Loans to any co-operative association or stabilization corporation shall be made upon the terms specified in this Act and upon such other terms not inconsistent therewith and upon such security as the board deems necessary.

(d) No loan or insurance agreement shall be made by the board if in its judgment the agreement is likely to increase unduly the production of any agricultural commodity of which there is commonly produced a surplus in excess of the annual marketing requirements.

Stabilization Corporations

Sec. 9. (a) The board may, upon application of the advisory commodity committee for any commodity, recognize as a stabilization corporation for the commodity any corporation if—

(1) the board finds that the marketing situation with respect to the agricultural commodity requires or may require the establishment of a stabilization corporation in order effectively to carry out the policy declared in section 1; and

(2) the board finds that the corporation is duly organized under the laws of a State or Territory; and

(3) the board finds that all the outstanding voting stock or membership interests in the corporation are and may be owned only by co-operative associations handling the commodity; and

(4) the corporation agrees with the board to adopt such by-laws as the board may from time to time require, which by-laws, among other matters, shall permit co-operative associations not stockholders or members of the corporation to become stockholders or members therein upon equitable terms.

(b) Any stabilization corporation for an agricultural commodity (1) may act as a marketing agency for its stockholders or members in preparing, handling, storing, processing, and merchandising for their account any quantity of the agricultural commodity or its food products, and (2) for the purpose of controlling any surplus in the commodity in furtherance of the policy declared in section 1, may prepare, purchase, handle, store, process, and merchandise, otherwise than for the account of its stockholders or members, any quantity of the agricultural commodity or its food products, whether or not such commodity or products are acquired from its stockholders or members.

(c) Upon request of the advisory committee for any commodity the board is authorized to make loans from the revolving fund to the stabilization corporation for the commodity for working capital to enable the corporation to act as a marketing agency for its stockholders or members as hereinbefore provided. Not less than 75 per centum of all profits derived by a stabilization corporation each year from its operations as such a marketing agency shall be paid into a merchandising reserve fund to be established by the corporation. No such payment shall be required whenever the fund is in such amount as, in the judgment of the board, constitutes a sufficient reserve for such operations of the corporation. Out of the remainder of such profits for the year the corporation shall repay any outstanding loan made under this subdivision and the accrued interest thereon, or if all such loans and accrued interest have been fully repaid, then it may distribute a patronage dividend to its stockholders or members. Such patronage dividend shall be paid to each stockholder or member on the basis of the total volume of the commodity or its products for the year marketed for his account through the corporation.

(d) Upon request of the advisory committee for any commodity the board is authorized to make loans from the revolving fund to the stabilization corporation for the commodity to enable the corporation to control any surplus in the commodity as hereinbefore provided and for meeting carrying and handling charges and other operating expenses in connection therewith. The board shall require a stabilization corporation to establish and maintain adequate reserves from its profits from its surplus control operations before it shall pay any dividends out of such profits. All losses of the corporation from such operations shall be paid from such reserves, or if such reserves are inadequate, then such losses shall be paid by the board as a loan from the revolving fund. Any amounts so loaned for payment of losses shall be repaid into the revolving fund by the corporation from future profits from its surplus control operations. Any stabilization corporation receiving loans under this subdivision for surplus control operations shall exert every reasonable effort to avoid losses and to secure profits, but shall not withhold any commodity from the domestic market if the prices have become unduly enhanced, resulting in distress to domestic consumers. Stockholders or members of the corporation shall not be subject to assessment for any losses incurred in surplus control operations of the corporation.

(e) A stabilization corporation shall keep such accounts, records, and memoranda, and make such reports with respect to its transactions, business methods, and financial condition, as the board may from time to time prescribe; shall permit the board to audit its accounts annually and at such other times as the board deems advisable; and shall permit the board, upon its own initiative or upon written request of any stockholder or member, to investigate the financial condition and business methods of the corporation.

(f) No loan shall be made to any stabilization corporation unless, in the judgment of the board, the loan is in furtherance of the policy declared in section 1.

Clearing House Associations

Sec. 10. Upon application of any co-operative association handling an agricultural commodity or of producers of an agricultural commodity, the board is authorized, if it deems such association or producers representative of the commodity, to assist in forming producer-controlled clearing house associations adapted to effecting the economic distribution of the agricultural commodity among the various markets and to minimizing waste and loss in the marketing of the commodity, if such assistance, in the judgment of the board, will be in furtherance of the policy declared in section 1. The board may provide for the registration, and for the termination of the registration, of any clearing house association in accordance with such regulations as the board may prescribe. Such clearing house associations are authorized to operate under rules adopted by the member co-operative associations and approved by the board. Independent dealers in, and handlers, distributors, and processors of, the commodity, as well as co-operative associations handling the commodity, shall be eligible for membership in the clearing house association: Provided, That the policy of such clearing house association shall be approved by a committee of producers which, in the opinion of the board, is representative of the commodity. Clearing house associations shall utilize the market news service and other facilities of the Department of Agriculture as far as possible.

PRICE INSURANCE

Sec. 11. The board is authorized, upon application of co-operative associations, to enter into agreements, subject to the conditions hereinafter specified, for the insurance of the co-operative association against loss through price decline in the agricultural commodity handled by the associations and produced by the members thereof. Such agreements shall be entered into only if, in the judgment of the board, (1) coverage is not available from private agencies at reasonable rates, (2) the insurance will be in furtherance of the policy declared in section 1, (3) the agricultural commodity is regularly bought and sold in the markets in sufficient volume to establish a recognized basic price for the market grades of the commodity, and (4) there is available with respect to the commodity such market information as will afford an accurate record of prevailing prices for the commodity covering a period of years of sufficient length to serve as a base to calculate the risk and fix the premium for the insurance. The agreements shall require payment of premiums so fixed and shall include such other terms as, in the judgment of the board, are necessary. The board may make advances from the revolving fund to meet obligations under any insurance agreement, but such advances together with the interest thereon shall, as soon as practicable be repaid from the proceeds of insurance premiums.

Administrative Appropriation

Sec. 12. For expenditures in executing the functions vested in the board by this Act (including salaries and expenses of members, officers, and employees of the board and per diem compensation and expenses of the commodity committees), incurred prior to July 1, 1930, there is hereby authorized to be appropriated the sum of $1,500,000. No part of the moneys appropriated in pursuance of this authorization shall be available for expenditures, including loans and advances, for the payment of which the revolving fund or insurance moneys are authorized to be used.

Avoidance of Duplication

Sec. 13. (a) The board shall, in co-operation with any governmental establishment in the Executive branch of the Government, including any field service thereof at home or abroad, avail itself of the services and facilities thereof in order to avoid preventable expense or duplication of effort.

(b) The President may by Executive order direct any such governmental establishment to furnish the board such information and data as such governmental establishment may have pertaining to the functions of the board; except that the President shall not direct that the board be furnished with any information or data supplied by any person in confidence to any governmental establishment in pursuance of any provision of law or of any agreement with a governmental establishment.

(c) The board may co-operate with any State or Territory, or department, agency, or political subdivision thereof, or with any person.

(d) The board shall, through the Secretary of Agriculture, indicate to the appropriate bureau or division of the Department of Agriculture any special problem on which a research is needed to aid in carrying out the provisions of this Act.

(e) The President is authorized, by Executive order, to transfer to or retransfer from the jurisdiction and control of the board the whole or any part of (1) any office bureau, service, division, commission, or board in the Executive branch of the Government engaged in scientific or extension work, or the furnishing of services, with respect to the marketing of agricultural commodities, (2) its functions pertaining to such work or services, and (3) the records, property, including office equipment, personnel, and unexpended balances of appropriation, pertaining to such work or services.

EXAMINATION OF BOOKS AND ACCOUNTS OF BOARD

Sec. 14. Vouchers approved by the chairman of the board for expenditures from the revolving fund pursuant to any loan or advance or from insurance moneys pursuant to any insurance agreement, shall be final and conclusive upon all officers of the Government; except that all financial transactions of the board shall, subject to the above limitations, be examined by the General Accounting Office at such times and in such manner as the Comptroller General of the United States may by regulation prescribe. Such examination, with respect to expenditures from the revolving fund pursuant to any loan or advance or from insurance moneys pursuant to any insurance agreement, shall be for the sole purpose of making a report to the Congress and to the board of expenditures and of loan and insurance agreements in violation of law, together with such recommendations thereon as the Comptroller General deems advisable.

MISCELLANEOUS PROVISIONS

Sec. 15. (a) As used in this Act, the term "co-operative association" means any association qualified under the Act entitled "An Act to authorize the association of producers of agricultural products," approved February 18, 1922. Whenever in the judgment of the board the producers of any agricultural commodity are not organized into co-operative associations so extensively as to render such co-operative associations representative of the commodity, then the privileges, assistance, and authority available under this Act to co-operative associations, shall also be available to other associations and corporations producer-owned and producer-controlled and organized for and actually engaged in the marketing of the agricultural commodity. No such association or corporation shall be held to be producer-owned and producer-controlled unless owned and controlled by co-operative associations as above defined and/or by individuals engaged as original producers of the agricultural commodity.

(b) It shall be unlawful for any member, officer, or employee of the board to speculate, directly or indirectly, in any agricultural commodity or product thereof, or in contracts relating thereto, or in the stock or membership interests of any association or corporation engaged in handling, processing, or disposing of any such commodity or product. Any person violating this subdivision shall upon conviction thereof be fined not more than $10,000 or imprisoned not more than ten years, or both.

(c) It shall be unlawful (1) for any co-operative association, stabilization corporation, clearing house association, or commodity committee, or (2) for any director, officer, employee, or member or person acting on behalf of any such association, corporation, or committee, to which or to whom information has been imparted in confidence by the board, to disclose such information in violation of any regulation of the board. Any such association, corporation, or committee, or director, officer, employee, or member thereof, violating this subdivision, shall be fined not more than $5,000, or imprisoned not more than five years, or both.

(d) The inclusion in any governmental report, bulletin, or other such publication hereafter issued or published of any prediction with respect to cotton prices is hereby prohibited. Any officer or employee of the United States who authorizes or is responsible for the inclusion in any such report, bulletin, or other publication of any such prediction, or who knowingly causes the issuance or publication of any such report, bulletin, or other publication containing any such prediction, shall, upon conviction thereof, be fined not less than $500 or more than $5,000, or imprisoned for not more than five years, or both: Provided, That this subdivision shall not apply to the members of the board when engaged in the performance of their duties herein provided.

(e) If any provision of this Act is declared unconstitutional, or the applicability thereof to any person, circumstance, commodity, or class of transactions with respect to any commodity is held invalid, the validity of the remainder of the Act and the applicability of such provision to other persons, circumstances, commodities, and classes of transactions shall not be affected thereby.

(f) This Act may be cited as the "Agricultural Marketing Act."
Approved, June 15, 1929.

APPENDIX E

CODE OF ETHICS OF THE AMERICAN NATIONAL RETAIL JEWELERS ASSOCIATION[1]

(Adopted August 27, 1922)

THE DUTY OF THE JEWELER TO HIS COMMUNITY, HIS FELLOW MERCHANTS AND HIS COMPETITOR

1. That just because he has opened a store is no reason why the community owes him a living. Remembering that he went into business voluntarily, he must do his duty by assuming his share of the community's obligations.

2. He must justify his right to live in his community by rendering that community service based on the highest standards of truth and honor in every transaction.

3. He must violate no confidence of a merchant in other lines but mingle with others, exchange ideas and join with them in promoting all things that are for the common good.

4. He should patronize his fellow merchant whenever and wherever possible that the community may prosper and he thereby share in such prosperity.

5. A fair profit based on the cost of doing business, plus a fair return on his investment, is the right of every merchant. Arrive at such profit and having done so, have *one price to all.* Play no favorites. Granting one reduction invites a second request.

6. Make adjustments cheerfully and give the customer the benefit of any doubt which may arise. A satisfied customer inside the store is worth a dozen disgruntled ones on the sidewalk.

7. Never make a contract without reading and fully understanding it, but after having done so, stick to your agreement and deal with your associates in a manner that will command trust and confidence. It is essential that we prove ourselves as honorable as we would have our competitors in all transactions.

8. As unfortunate habits of giving service without charge have grown up with our business, it should be the duty of every jeweler

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[1] E. W. Lord, *Fundamentals of Business Ethics,* pp. 155–160.

to eliminate this evil by making a charge for all service. Have the courage to ask fair remuneration for any work offered. It is better to be without the work than to do it without profit.

9. Never advise a customer to buy an article you would not buy yourself if you were in his position. Never urge a customer to buy beyond his means. If it means taking advantage of the other fellow, don't do it.

10. When a new competitor enters the field, welcome him and help him to information and assistance that will enable him to overcome the difficulties we had so much trouble in surmounting. It should be our duty and pleasure to assist in every way our less experienced competitors.

11. The young jeweler who starts with small capital and who does most of his own work, should ever remember the honorable nature of his calling and never make the mistake of supposing that he can do work cheaper than his competitor who employs several craftsmen. He should rather contend that because he attends his own work in person, it is better and therefore worth more, however he should assume such a position in a way not detrimental to his larger competitor.

12. When estimates are asked on work done or articles sold by another jeweler, with plain intent to test the fairness of price charged, they should invariably be declined.

13. It is deemed unethical to train a competitor's salesman or delivery or to try to obtain information as to a competitor's methods or stock by questioning or bribing his employees.

14. To induce a competitor's employees to leave him unless with the employer's consent.

15. To injure directly or indirectly, the business reputation or prospects or business of a fellow jeweler or other merchant or to make false or disparaging statements or insinuations relative to a competitor's merchandise, prices, business, financial or personal standing. Boosting a competitor or his wares will elevate you in your customer's opinion. If you can't say good, say nothing.

16. To stimulate in one's own merchandise the trade mark, trade name, slogan advertising or appearance of a competitor's ideas or goods.

17. To threaten to withdraw advertising unless a competitor's advertising is excluded or unless discriminatory favors are granted.

18. To claim or exercise a monopoly.

19. To obtain estimates on a competitor's goods through a third party with the intent to undersell.

20. To sell or offer to sell under a competitor's price in order to beat him out of a sale or force him out of business.

21. The customer relies on the expert knowledge of the retail jeweler and it behooves the jeweler, therefore, to thoroughly post himself on quality and values of articles which he offers for sale. After acquiring such knowledge, the jeweler must strictly live up to every guaranty of quality which he gives his customer.

22. Immediately upon receipt of new prices showing an advance in price, the jeweler should mark his goods in conformity. To neglect this and then insinuate to a customer that there must be something wrong with your competitor's prices is decidedly unethical. Likewise in case of reductions in price, merchandise should be immediately marked down. Dealers in the same towns or cities should cooperate in this matter.

23. Refrain from false and misleading advertising. The truth in advertising should be jealously adhered to by every jeweler. Follow the same practice when selling over the counter. Make your spoken word and written word synonymous.

24. Do not give information concerning customer's purchases or use their names in advertising without their consent.

25. Establish a credit at a good bank. Sign one note for money borrowed rather than many notes for goods borrowed. It is safer to owe one man than many.

The Jeweler and His Relation to His Employees

1. A cheerful "Good Morning" to the clerks makes for loyalty, interest and industry and costs nothing. Clerks are human as well as proprietors, let's consider them so.

2. Be quick to reward industry, loyalty and ability and give employees no cause to complain of their treatment at your hands. Be sympathetic with them in trouble, stretch forth a helping hand and give them substantial assistance if necessary.

3. Do not place temptation in their way lest honesty depart and a promising career be ruined.

4. Provide fair working hours, compensation worthy of the individual and working conditions that are pleasant.

5. Foreign workmen who come into our employ and who are not familiar with American ways should be carefully educated in the provisions of this Code.

6. Do not encourage employees by example or advice in what may be termed "shady" transactions or "tricky" salesmanship.

7. Do not take all big sales unto yourself but give worthy employees a chance.

8. Do not criticize an employee or try to belittle him before customers.

THE JEWELER AND HIS DUTY TO THE MANUFACTURER, WHOLESALER, JOBBER OR IMPORTER

1. Pay bills when due or explain to your creditors your failure to do so.

2. Take cash discounts only in accordance with the terms quoted.

3. Merchandise shipped on regular order should not be returned without permission from the seller. Such permission should not be requested after a lapse of a reasonable period of time and in no case should merchandise be returned freight collect.

4. Accept goods delivered to railroads in good condition and look to the railroads for adjustment for damages. Deductions should not be made from invoice to cover damage for which the shipper is not responsible.

5. Place orders only in good faith and accept goods so purchased. Report shortages promptly.

6. Do not buy minimum amounts of merchandise in order to keep other dealers from getting the same line.

7. Follow out promises of co-operation through advertising and dealers' helps, with performance.

8. Treat the traveling salesmen with courtesy. They are entitled to a hearing but at the same time should be impressed with your firmness that they may not become insistent. Make your appointments as early as possible and keep them, remember the salesman is traveling on schedule. We should condemn the gossiping salesman and refuse him a hearing.

THE MANUFACTURER, WHOLESALER, IMPORTER AND JOBBER AND HIS RELATION TO THE RETAIL JEWELER

1. There is some question as to the propriety of the retail jeweler suggesting a Code of Ethics for other branches of the industry and we would not be so presumptuous as to do so. However there are some matters, from the retailer's point of view, in his relation to the Manufacturer, Wholesaler, Importer or Jobber, that are the concern of the Retailer and to that end we have prepared the following sug-

gestions which we hope will meet the views of the other branches of the Industry and be given recognition in any Code of Ethics which they may later see fit to promulgate within their own organization. . . .

2. Manufacturers, Wholesalers, Importers, and Jobbers should at all times brand their goods exactly as represented.

3. Should not sell at retail in any instance. Neither should they quote net prices to the consumer or permit their employees to do so. Should not give out goods on memorandum to anyone save legitimate jewelers carrying this class of merchandise in stock. They should not publish net prices in trade publications, leaflets, booklets, catalogs, or circulate through the mails or any common carrier, literature which will convey price information to the consumer other than resale prices which are consistently marked to include a satisfactory net profit.

4. Watch manufacturers should not repair watches for owners at a nominal cost but should return such watches through legitimate dealers located at the home address of the owner with charges in conformity with the American National Retail Jewelers' Association's suggested repair price list.

5. They should not scale quantity discounts to the extent of handicapping the small buyer and thereby induce him to buy beyond his means.

6. Should not advertise price reductions at the beginning of the retail selling season of goods which dealers have bought for that season.

7. Should not substitute merchandise without the consent of the buyer or ship goods in excess of amounts bought, nor place goods on back order without advising customer and obtaining his consent.

8. Should furnish the buyer in all instances, with a copy of his order.

9. Should not sell to other lines of business, merchandise belonging properly to the jewelry trade.

10. Should not overstock an individual merchant nor a community by selling to general stores or other stores, goods similar to those the jeweler has bought in sufficient quantity.

11. Should not extend credit to merchants who have proven themselves dishonest until full confidence has been restored and obligations paid in full.

12. Should discourage bribery as a reprehensible practice.

13. Any Code of Ethics must be predicated upon the basic principles of truth and honesty. Whatsoever things are true, whatsoever things are honest are the things for which jewelers must contend.

14. The honor of the craft should be dear to every jeweler and he should remember that his own character and conduct reflects honor or reproach on the industry as a whole.

APPENDIX F

BIBLIOGRAPHY

Until a decade ago there were few books dealing directly with marketing. Today, in contrast, there is a veritable deluge of such books so that it would be impractical to list any considerable proportion of them in this bibliography. What the authors have attempted to do is to give those books which have proved helpful in the preparation of this text and which we believe will be of interest to students of marketing. Our problem has been one of selection and others will doubtless differ with our judgment in certain cases. The works listed are believed to be representative of the field, however.

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Date Due

[illegible] '37	[illegible]		
[illegible] Oct '37	12Oct37		
10Aug'39	4Aug'39		
10Mar'40	7Mar[illegible]		
2[illegible]May'41	19May'41		
2Jul'41	1Jul'4[illegible]		
15Jul'41	15Jul'41		
[illegible]			
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Market organization, main
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